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90-84

No.

Supreme Court, U.S.
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1990

EDUCATION ASSISTANCE CORPORATION,
a South Dakota corporation,
Petitioner,

vs.

LAURO F. CAVAZOS,
Secretary of Education of the United States,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

1. Are the assets of a private nonprofit insurer of loans made by financial institutions under the Guaranteed Student Loan Program (20 U.S.C. § 1071 *et seq.*) "property" protected from confiscation by the Takings and Due Process Clauses of the Fifth Amendment, or is the Congress free to seize those assets to fund the Federal Government's obligations under the Program?

2. Does *Bowen v. Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986), permit Congress to add provisions to existing government contracts with private entities effectively requiring those entities to pay over the bulk of their assets to the Government?

LISTS REQUIRED BY RULES 14.1(b) and 29.1

Pursuant to this Court's Rules 14.1(b) and 29.1, petitioner certifies that the names of all parties to the proceeding in the Court of Appeals appear in the caption of the case and that it has no parent company. Its only subsidiary company is wholly owned.

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IN THE

Supreme Court of the United States

October Term, 1990

No.

EDUCATION ASSISTANCE CORPORATION,
a South Dakota corporation,

Petitioner,

vs.

LAURO F. CAVAZOS,
Secretary of Education of the United States,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Petitioner Education Assistance Corporation, plaintiff in the District Court and appellant in the Court of Appeals, respectfully petitions this Court to issue a writ of certiorari to the United States Court of Appeals for the Eighth Circuit to review the judgment in *Education Assistance Corp. v. Cavazos*, 902 F.2d 617 (CA8 No. 89-5393SD; Apr. 10, 1990).

OPINIONS BELOW

The Court of Appeals' opinion is reported at 902 F.2d 617 and is reproduced at pp. 1a-25a of the Appendix to this Petition (hereinafter "Pet. App."). The opinion of the United States District Court for the District of South Dakota is unreported and is reproduced at Pet. App. 27a-47a.

JURISDICTION

The Court of Appeals' opinion was issued and its judgment entered on April 10, 1990. This Court's jurisdiction arises under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISION, STATUTES, AND REGULATIONS INVOLVED

Relevant portions of the Fifth Amendment to the Constitution and of the Higher Education Act of 1965, as amended, 20 U.S.C. § 1071 *et seq.*; the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, Title III, Subtitle A, 101 Stat. 1330, 1330-36 to 1330-38; and Department of Education Guaranteed Student Loan Program regulations, 34 C.F.R., Part 682, are set out at Pet. App. 48a-55a.

STATEMENT OF THE CASE

A. The Facts

Education Assistance Corporation ("EAC") is a private nonprofit corporation organized under South Dakota law in 1978 to act as the "guaranty agency" in that state under the Guaranteed Student Loan ("GSL") Program created by the Higher Education Act of 1965 (as amended, "the Act").[1] EAC is in the business of insuring financial institutions against losses incurred from unsecured loans for post-secondary education. In turn, EAC relies on the contractual commitment of the Secretary of Education to reinsure it against all or part of its losses.

[1]The GSL Program is governed by § 421 *et seq.* of the Act, 20 U.S.C. § 1071 *et seq.* Unless otherwise noted, all references to the Act are to the current version of Title 20 of the United States Code. The Omnibus Budget Reconciliation Act of 1987 (*see* n.4, *infra*), reprinted at Pet. App. 49a-53a, made certain amendments to the Act, effective December 22, 1987, but also repealed them by a sunset provision effective September 30, 1989. Pet. App. 52a-53a.

The Act was originally intended to encourage the development of new non-federal student loan insurance programs in states, and to strengthen those programs already existing. During the early years of the GSL Program, however, loans were guaranteed, for the most part, by the federal government itself.[2]

In 1976, the Act was amended to increase student access to the GSL Program by further encouraging states that had not already done so to take steps to initiate non-federal insurance programs. Pub. L. No. 94-482, § 127(a), 90 Stat. 2081, 2099-2100. The 1976 amendments increased the maximum rate of federal reinsurance and provided for payments to bolster cash reserves and to cover some of the costs of administration. S. Rep. No. 882, 94th Cong., 2d Sess. 22, *reprinted in* 1976 U.S. Code Cong. & Admin. News 4713, 4734; H.R. Conf. Rep. No. 1701, 94th Cong., 2d Sess. 185, *reprinted in* 1976 U.S. Code Cong. & Admin. News 4877, 4886.

EAC was organized in 1978 and was designated by the Governor of South Dakota as the guaranty agency for that state under the Act. EAC is a private corporation, not affiliated with either the state or the federal government. To begin participating in the GSL Program, EAC entered into a series of contracts with the Commissioner of Education in 1978.[3] The contracts include three referred to as the Basic

[2]A separate program of direct federal loan insurance was authorized to be offered only where, and only as long as, these non-federal insurance programs were unable to meet demand in a particular state. Pub. L. No. 89-329, § 421(a), 79 Stat. 1219; S. Rep. No. 673, 89th Cong., 1st Sess., *reprinted in* 1965 U.S. Code Cong. & Admin. News 4027, 4061-64. In 1968, federal reinsurance was authorized as further support for non-federal programs. Pub. L. No. 90-460, §§ 3(a),(b), 82 Stat. 634; H.R. Rep. No. 1319, 90th Cong. 2d Sess., *reprinted in* 1968 U.S. Code Cong. & Admin. News 3116, 3130.

[3]Upon the creation of the Department of Education, the Secretary succeeded to the functions of the Commissioner, including his obligations under these contracts. 20 U.S.C. § 3441(a)(1). All further references will be to the Secretary.

Contract, the Reinsurance Contract, and the Supplemental Reinsurance Contract. (Bishop Aff., Exs. C,D,E) By December 22, 1987, each of these contracts had been amended several times with the consent of both the Secretary and EAC. Each contract, as amended, was in effect when the Omnibus Budget Reconciliation Act of 1987 (the "Budget Act")[4] was passed and approved that day.

The Basic Contract recognized EAC as a guaranty agency under the GSL Program and provided that lenders which receive EAC's insurance would also receive a federal interest subsidy.

The Reinsurance Contract (¶2) provided that the Secretary "*shall* reimburse the Agency [EAC] in an amount equal to 80% of the amount expended by it in the discharge of its insurance obligations . . . ," subject to requirements that the lender and EAC exercise due diligence in making, servicing, and collecting defaulted loans. (Emphasis supplied.)

The Supplemental Reinsurance Contract (¶2) provided for reinsurance at 100% for as long as the total of reinsurance payments made by the Secretary to EAC during any year does not exceed 5% of the amount of loans in repayment at the end of the previous year. EAC has always been eligible for 100% reinsurance, but if its claims rate ever exceeds 5%, reinsurance can drop to as low as 80%. EAC would be required to make up the difference.

The agreements may be terminated by either party, though the Secretary may do so only for cause. (Reinsurance Contract, ¶12, Supplemental Reinsurance Contract, ¶10) The Reinsurance and Supplemental Reinsurance Contracts make clear that termination will not relieve EAC from its existing guaranty obligations or the Secretary from his commitment to provide reinsurance for those obligations. Each party is required to meet "obligations incurred . . . before the effective date of termination. . . ." *Id.*

[4]Pub. L. No. 100-203, §§ 3001-3002, 101 Stat. 1330-36 to 1330-38. (Pet. App. 49a-53a)

Congress did not, either in the Act or otherwise, reserve to itself or the Secretary the right unilaterally to alter the contracts. Besides these contracts between EAC and the Secretary, the Act itself provided (through December 21, 1987) that a "guaranty agency shall be deemed to have a contractual right against the United States, *during the life of such loan,* to receive reimbursement [as described above]." 20 U.S.C. § 1078(c)(1)(A) (emphasis supplied). Pet. App. 48a-49a. In amending the Act in 1986 to add express references to the contractual nature of the guaranty agencies' rights, Congress said that it was not making new commitments, but only "clarify[ing]" existing ones. H.R. Rep. No. 383, 99th Cong., 2d Sess. 39, *reprinted in* 1986 U.S. Code Cong. & Admin. News 2572, 2610.

Several of the contracts included "subsequent changes" clauses. That in the Reinsurance Contract (¶1) is typical: "The Agency [EAC] shall be bound by all changes in the Act or Regulations in accordance with their effective dates."

From time to time, regulations governing EAC's participation in the program were modified. These changes did not, however, interfere with EAC's contractual obligations or its capacity to operate. By continuing its participation in the GSL Program, EAC accepted these modifications, and they became part of its contracts with the Secretary.

By December 22, 1987, EAC, in reliance on the reinsurance commitment authorized by the Act and made by the Secretary, had insured $421.5 million (original principal amount) of student loans to nearly 90,000 persons, $307.7 million of which was outstanding as of September 30, 1988. These loans will not be fully repaid before the years 2002 or 2003. Until then, EAC has continuing contractual obligations to the lenders which have relied on its guaranties.

EAC's rights to receive reinsurance from the Secretary to back up its guaranties of these loans and to maintain the

integrity of its reserves, or guaranty fund, are essential to its meeting those obligations. (Bishop Aff., ¶¶14, 24, 26)

Only EAC is liable on its insurance. Lenders may look only to EAC if a borrower defaults. The Secretary's only obligation relating to the repayment of the loans is to reinsure EAC; he does not himself insure them. There is no provision in the Act for direct payments from the Secretary to lenders if the guaranty agency fails.[5]

Although reinsurance payments due from the Secretary may reimburse EAC for 80–100% of its guaranty losses to lenders, its administration and operational requirements for the existing loans will be substantial.[6] For these loans, EAC still has the duties of overseeing lenders, monitoring enrollment, assisting lenders with default prevention, and collecting defaulted loans after it pays claims. (*Id.*, ¶12)

All of EAC's available financial resources are in its guaranty fund. EAC's reserves consist primarily of insurance fees charged lenders (usually passed on to borrowers) and earnings on the fund. It also includes federal advances;[7] reinsurance payments, administrative cost allowances, and other amounts paid under the Act to reimburse EAC for

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[5]The Secretary has so informed lenders. (Bishop Aff., Ex. I)

[6]In connection with an extensive analysis conducted by Touche Ross & Co. of the adequacy of EAC's existing guaranty fund to meet its future cash requirements arising from existing obligations, EAC estimated that from 1988 until 2002 its operating expenses relating solely to the existing loans will be $9.5 million. (*Id.*, ¶24)

[7]Under another contract with the Secretary, EAC received cash advances from time to time to strengthen its reserves against lenders' default claims. As of September 30, 1988, the outstanding amount of federal advances totalled about $2.3 million, all of which had been received over four years earlier. (*Id.*, ¶11) There is a dispute between the Secretary and EAC, not part of this action, over the Secretary's right to have a portion of these funds returned before the time called for in the contract.

costs already incurred; and money it retains as a fee for post-default collections. Other than reinsurance payments (and reimbursement for collecting defaulted loans), EAC is entitled to no more money of any sort from lenders, borrowers, or the Secretary for the loans it has guaranteed. The existing fund and the earnings it generates, therefore, must be sufficient to meet all guaranty obligations to lenders and substantially all EAC's costs of administration and operation over the next 12 to 13 years for the loans already guaranteed. (*Id.*, ¶24)

B. The Challenged Legislation and EAC's Response

On December 22, 1987, Congress passed and the President approved the Budget Act. To help meet the mandated budget reduction targets of the Gramm-Rudman-Hollings Act, Pub. L. No. 99-107, 99 Stat. 1037, Congress sought to reduce expenditures without directly cutting benefits to students and lenders under the popular GSL Program. It funded a one-time reduction in GSL Program appropriations by directing the Secretary to seize $250 million from the assets of certain of the guaranty agencies.[8] EAC's required contribution under the statutory formula was $6,607,592 of its net cash reserves at that time of approximately $9.2 million.[9]

EAC knew that allowing its resources to be depleted by about 70% would jeopardize its capacity to continue opera-

[8]Pub. L. No. 100-203, § 3001(a), adding 20 U.S.C. § 1072(e)(4) (Pet. App. 51a) The Secretary may argue that the Budget Act represents Congress's attempt to address the accumulation of "unneeded" reserves by guaranty agencies. Even were this the case, Congress does not have the power to decide that some entities have "too much" money and simply seize the difference. The Budget Act, however, was concerned solely with reduction of the deficit. It directed the one-time seizure of $250 million regardless of the actual amount of allegedly "excess" reserves. *Id.*

[9]Total cash reserves as of September 30, 1987 of $10,764,470, less $1,541,624 of federal advances which the Secretary has additionally demanded be repaid. *See* n.7, *supra*.

tions and to honor the guaranty commitments it had made to lenders on existing loans. It also feared that its continuing business as usual after the Budget Act amendments might be seen as impliedly consenting to the new statutory exaction. It therefore immediately notified the Secretary that it would not consent to incorporation of the amendments into its existing contracts and, to avoid any implication that it had done so, ceased issuing new loan guaranties.[10] After futile attempts to obtain a waiver of the seizure provisions from the Secretary,[11] EAC refused a final demand in September 1988 that it surrender the $6.6 million. Over the next 11 months, the Secretary effected the seizure of the full amount by withholding reinsurance payments he owed EAC.[12]

C. The Proceedings Below

On December 12, 1988, EAC sued the Secretary for declaratory and monetary relief, invoking the District Court's ju-

[10]To ensure continued access to the GSL Program in South Dakota until its dispute with the Secretary could be resolved, EAC promptly made arrangements for another guaranty agency to insure loans newly guaranteed after December 21, 1987 that it would otherwise itself have insured. No student has been deprived of a student loan because of EAC's action in contesting the constitutionality of the Budget Act amendments.

[11]The Budget Act allowed the Secretary to grant a waiver under conditions specifically described. Pub. L. No. 100-203, § 3001(a), adding 20 U.S.C. § 1072(e)(3)(A) (Pet. App. 50a-51a) The waiver provisions were not designed to ameliorate the constitutional problems created by the Budget Act seizure, but to provide some relief in three fairly narrow circumstances, two of which EAC thought applied to it. When the Secretary decided EAC did not qualify for a waiver, it unsuccessfully sought judicial review of the waiver denial as part of the proceedings below. It does not pursue that aspect of the case here.

[12]To avoid impairment of its bond ratings and to permit it to complete required financings, the entity which makes a secondary market in GSL Program loans in South Dakota has loaned EAC money to assure EAC's continued operation. EAC must pay this money back, which it will be unable to do unless it succeeds in this lawsuit.

risdiction under 28 U.S.C. § 1331 to resolve the federal questions presented by the case. These were chiefly (1) a breach of contract claim, which resolved itself into the question whether EAC had already consented to the seizure of its assets by virtue of "subsequent changes" clauses in its contracts and a similar provision in GSL Program regulations, and (2) if not, whether the Budget Act amendments that authorized the seizure violate the Fifth Amendment.

On cross-motions for summary judgment, the District Court dismissed the complaint, holding that, by agreeing to the "subsequent changes" clauses, EAC had consented in advance to any amendment, including the one requiring the seizure. Pet. App. 43a-45a. In light of this holding, the District Court then held that EAC's rights in its assets were not "vested" for Fifth Amendment purposes and thus not protected from seizure. Pet. App. 46a.

The Court of Appeals disagreed with the District Court's analysis of the "subsequent changes" clause because it was "not convinced . . . that an agency, without any direction from Congress, may reserve the right to alter the terms of its agreements with private individuals." Pet. App. 22a n.19. Nevertheless, it held that, in light of the purpose of the GSL Program and the contractual and regulatory environment in which it thought guaranty agencies exist, EAC's interest in its assets "is analogous to that of a trustee holding money for the benefit of . . . the general public" (Pet. App. 19a) and, therefore, not entitled to Fifth Amendment protection.

The court also held that, even though EAC and the Secretary had "not contemplated" that a statutory amendment might require EAC to surrender the bulk of its assets, this Court's decision in *Bowen v. Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986), allowed Congress effectively to do so because the "social welfare" nature of the GSL Program gave Congress a free hand to alter the contracts in any way it saw fit. Pet. App. 23a.

The Court of Appeals held, notwithstanding the firm commitments made to EAC in its contracts with the Secretary and Congress's statutory acknowledgement of the contractual nature of EAC's rights against the United States during the life of the loans (20 U.S.C. § 1078(c)(1)(A)), that Congress had "implicitly reserved" (Pet. App. 22a) the right retroactively to alter those commitments, despite reliance on them by EAC, lenders, students, schools, and secondary market participants. While acknowledging this Court's repeated admonitions that Congress may not repudiate its obligations, the Court of Appeals concluded that insisting upon the seizure of most of EAC's assets as a condition of the Secretary's continuing to pay reinsurance on already insured loans did not amount to repudiation. Accordingly, the court affirmed dismissal of the complaint.[13]

REASONS FOR GRANTING THE WRIT

This case presents an important question of law under the Fifth Amendment that is bound to recur with great frequency as the political branches address the need to reduce

[13]The Secretary has also prevailed in similar cases decided in two other Courts of Appeals. *South Carolina State Education Assistance Authority v. Cavazos*, 897 F.2d 1272 (CA4 Nos. 89-2975, -2976, -2978, & -2982; Mar.-7, 1990); *Ohio Student Loan Commission v. Cavazos*, 900 F.2d 894 (CA6 Nos. 89-3168 & -3238; Apr. 2, 1990). The guaranty agencies in those cases have previously filed petitions for certiorari, all of which are pending. Nos. 89-1873 (Md.); 89-2027 (S.C.); 90-4(N.C.); 90-13 (Ohio). While these cases present the same core issue under the Fifth Amendment, this case is unlike the others in that (1) this petitioner is a private nonprofit corporation, rather than an agency of a state, and (2) this petitioner ceased guaranteeing new loans when the Budget Act amendments took effect, so that all of its loans pre-exist that enactment. EAC does not contend that either distinguishing fact is necessarily significant to the proper decision of the constitutional issue presented, but merely that to the extent state agency status or continuing to insure may be seen as complicating the constitutional question, neither is present here.

the crushing federal budget deficit. Under principles articulated by this Court during the national crisis of the Great Depression (*Lynch v. United States*, 292 U.S. 571 (1934); *Perry v. United States*, 294 U.S. 330 (1935)), the Government is not free to meet fiscal emergencies by abrogating its obligations. Even more basically, the Government is forbidden to solve its financial problems by seizing the property of its citizens and using it for the perceived higher public good. *Cf. United States v. Security Industrial Bank*, 459 U.S. 70, 75-76 (1982).

Because these principles are so well established in this Court's cases, the Secretary does not attempt a frontal assault on them. Rather, he has maintained, and persuaded the court below, that money earned in part under contracts with the Secretary (and in part by charging insurance premiums and investing its earnings) is not "property" that a private entity may keep in the face of a congressional determination to confiscate it, so long as that money is subject to "extensive federal regulation." Pet. App. 18a.

While the court said it did not adopt any such general rule, but would determine the protected status of property under "the unique circumstances of each case" (*id.*), its analysis of the circumstances in this case gives scant protection to the traditional property interests of any private entity subject to governmentally imposed restrictions on the uses to which its assets may be put. If the Court of Appeals' approach were to prevail, the treasuries of a variety of regulated entities—from banks and insurance companies and nonprofit corporations to government contractors—would be fair game for seizure by Congress and other legislatures whenever that revenue source seems more attractive than others.

Particularly vulnerable under the Court of Appeals' test will be the many private entities like EAC that have been organized in response to congressional incentives, for the

express purpose of performing a role that Congress had decided could best be carried out by the private sector.[14] Almost by definition under the Court of Appeals' analysis, all such entities will be found to exist in the "unique circumstances" that the court found sufficient to allow expropriation here.

This Court has never before faced the precise issue of the Government's ability to expropriate for its own budgetary purposes the assets of private entities with some relationship to it. In attempting to divine this Court's response to that issue, the Court of Appeals has misapplied this Court's decision in the quite different factual setting of *Bowen*, holding that *Bowen* allows Congress to add provisions to government contracts "not contemplated" (Pet. App. 23a) by the parties, even if those provisions work a seizure as sweeping as that accomplished here, whenever the program involved can be called a "social welfare program." *Id.* This Court ought to grant certiorari to correct this dangerous misinterpretation of *Bowen*.[15]

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[14]Many private entities carry out such functions. As under the GSL Program, Congress has turned to the private sector to serve a role in numerous programs, from making loans to small businesses to providing housing and community development. *See generally* 7 U.S.C. § 1932 (authority for establishment of Nonprofit National Corporation Loan and Grant Program, 7 C.F.R. § 1980.601 *et seq.*); 15 U.S.C. §§ 681-687m (Small Business Investment Companies); 15 U.S.C. §§ 687(c), 695-697c (Loans to State and Local Development Companies). Although there are differences among these programs, and the petitioner does not represent that any of them is identical in structure to the GSL Program, each of them involves some combination of federal and state, local, or private financial commitments and extensive federal regulation over entities' structure and organization, purpose, and use of assets. The repercussions of the Secretary's litigation success in this case would have profound implications for all these entities and, of course, for Congress's ability to use this approach in the future.

[15]EAC thus seeks review under the "important question of federal law" branch of this Court's exercise of its certiorari jurisdic-

(Footnote continued on next page)

I. THE FIFTH AMENDMENT PROTECTS THE PROPERTY OF PRIVATE ENTITIES INVOLVED IN PROGRAMS SUBJECT TO FEDERAL REGULATION.

The Court of Appeals, in exonerating this seizure from constitutional fault, has emphasized the supposed unique circumstances (1) that the "limited" purpose of EAC and its reserves is "to service the federally-created GSL program" (Pet. App. 18a); (2) that the contracts between EAC and the Secretary included "subsequent changes" clauses; and (3) that the Act and regulations had previously been amended

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tion. At this time, there is no split in the circuits to point to. As noted above (n.13), the Fourth and Sixth Circuits reached substantially the same result as did the Eighth in this case, although the courts' analyses are, in some respects, a little different. But this Court has often taken up important federal questions even where the courts of appeals have been in agreement. Indeed, *Lynch v. United States*, 292 U.S. 571 (1934), the leading case on the Government's constitutional inability to avoid contractual commitments in order to save money, was before this Court on certiorari to two courts of appeals which had agreed in ruling for the Government. *See Wilner v. United States*, 68 F.2d 442 (CA7 1934); *Lynch v. United States*, 67 F.2d 470 (CA5 1933).

Agreement among the circuits is no sure sign of correctness. As recently as *Maislin Industries, U.S., Inc. v. Primary Steel, Inc.*, U.S. , 58 U.S.L.W. 4862 (No. 89-624; June 21, 1990), this Court found it necessary to reject the holdings of five of the six courts of appeals which had decided the same question. 58 U.S.L.W. at 4864 n.8. Moreover, all three courts of appeals which have decided the constitutionality of the seizure of guaranty agency reserves have done so recently. The Fourth and Sixth Circuits reversed the contrary holdings of district judges in South Carolina, Maryland, and Ohio. Far from being settled, the controversy is still alive in other courts. *E.g., Great Lakes Higher Education Corp. v. Cavazos*, (CA7 No. 89-2748; argued May 15, 1990). And, as shown herein, the result reached by the Eighth Circuit is contrary to important decisions of this Court. *Cf. Perpich v. Department of Defense*, U.S. , 58 U.S.L.W. 4750, 4751 (No. 89-542; June 11, 1990) (certiorari granted "[b]ecause of the manifest importance of the issue").

in ways that EAC had accepted. These circumstances, in the court's view, deprived EAC's assets of constitutional protection.[16]

A. EAC's "Purpose" Is to Fulfill Its Insurance Obligations to Lenders and to Administer Its Insurance Program.

The Court of Appeals has fundamentally misconceived the purpose of EAC and its reserves. They exist to carry out EAC's own commitments to lenders to stand behind the hundreds of millions of dollars in loans on which it has outstanding guaranties. Although EAC contracted with the Secretary in response to congressional urging, and although it certainly operates in the milieu of the GSL Program, its separate existence and independence were part of the very rationale for its existence and for the way Congress structured the GSL Program.[17]

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[16]The Court of Appeals, concluding that EAC's reserves are not "property," did not reach the question whether they had been seized without due process or just compensation. Pet. App. 15a n.14. The District Court found it "clear that if the portion of the reserve fund claimed under the Budget Act was constitutionally protected property, there was a taking." Pet. App. 45a-46a.

[17]Significantly, the stated statutory purpose of the GSL Program is to "enable the Secretary (A) to encourage State and nonprofit private institutions and organizations to establish adequate loan insurance programs . . . and (D) to guarantee a portion of each loan insured under a program of a State or of a nonprofit private institution or organization which meets the requirements of section 1078(a)(1)(B) . . ." 20 U.S.C. §§ 1071(a)(1), (4). Pet. App. 48a. Thus, Congress envisioned the guaranty agencies establishing state or private programs, with the Secretary encouraging and reinsuring them, not the Secretary operating a federal program in which the agencies played some subsidiary part. *Cf.* 20 U.S.C. § 1071(a)(1)(B). (authorizing the Secretary "to provide a Federal program of student loan insurance for students or lenders who do not have reasonable access to a State or private nonprofit program of student loan insurance. . . .").

Although the Secretary has undertaken to reinsure EAC's insurance losses, and that reinsurance obligation is at the heart of the statutory environment in which EAC exists, it is only EAC that has insured the lenders against losses. If Congress renders EAC incapable of meeting its insurance commitments and its integrally related loan servicing obligations, the lenders have no recourse against the Government. The "reserve fund" which the Secretary has seized was EAC's only source of wherewithal to carry out its duties.

To deny that EAC's assets are constitutionally protected "property" because EAC and its assets have the purpose of guaranteeing and servicing loans made within the GSL Program consigns to constitutional outer darkness all entities created to play a part in carrying out a larger public purpose, even though their particular purpose is more accurately described as carrying out the individual obligations they have undertaken.

Precisely the same rationale advanced by the Court of Appeals could have been used to permit Congress to accomplish what this Court said it could not do in *Lynch*. In that case, Congress sought unsuccessfully to avoid the Government's obligation to pay death benefits on policies of insurance issued to service members during World War I. If, however, instead of having the Bureau of War Risk Insurance issue the insurance directly, Congress had chosen to encourage private entities to issue and service the policies by having the Bureau reinsure the insurers, we would have a situation directly analogous to that presented by this case. As Congress wished to do in *Lynch*, the Government would have succeeded in avoiding the expense of satisfying its contractual obligations, and, contrary to what this Court was willing to allow there, the service member, who had paid his premium for insurance, would have lost coverage. But what this Court denounced as "an act of repudiation . . . with all the wrong and reproach that term implies," 292 U.S. at 580, is here excused as reasonable regulation.

EAC's property rights in its assets stem from the same state laws that govern and protect the property of every other nonprofit corporation created under the laws of South Dakota.[18] EAC holds title to, grants security interests in, directs the day-to-day investment of, spends, and exercises every other right of ownership in its assets. There was not a single fact before the Court of Appeals to suggest that, before December 22, 1987, the Secretary had ever claimed title to any of EAC's assets.[19] Nothing in the Act or the regulations has ever purported to confer property rights over EAC's reserve fund.

These are the "existing rules or understandings that stem from an independent source such as state law" which this Court has said define the property interests protected by the Constitution. *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1011 (1984), quoting *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972). The Court of Appeals' decision ignores this state law in favor of a vague reference to federal regulations (Pet. App. 19a-20a) which, after the fashion of traditional insurance regulations,[20] require that EAC invest its reserves in prudent ways and use those reserves only to carry out its

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[18]In authorizing the Secretary to enter into contracts with "nonprofit private institutions or organizations," 20 U.S.C. §§ 1071(a)(1)(A), (D) (Pet. App. 48a); 1078(b)(1), (c)(1)(A), Congress designated an entity whose legal characteristics it knew to be defined by state law. EAC's powers under South Dakota law are typical of the powers of nonprofit corporations under the laws of other states. Thus, EAC has "power to purchase, take, receive, lease, take by gift, devise or bequest, or otherwise acquire, own, hold, improve, use and otherwise deal in and with, real or personal property. . . ." S.D. Codified Laws Ann. § 47-22-55 (1983). It has the "power to sell, convey, mortgage, pledge, lease, exchange, transfer and otherwise dispose of all or any part of its property and assets." *Id.* at § 47-22-56.

[19]EAC is obligated to repay certain federal advances received early in its life (*see* n.7, *supra*).

[20]*See generally* Fla. Stat. Ann § 625.302 *et seq.* (1984); Ill. Rev. Stat. 1989, ch. 73, par. 736 *et seq.*; Minn. Stat. § 60A.11 (1988).

functions under the GSL Program (*e.g.*, 34 C.F.R. §§ 682.410(a)(2), (3), (5) (Pet. App. 54a)). If these regulations deprive EAC's assets of protection from seizure by the Government, the assets of all insurers, certainly those of all nonprofit insurers, are at risk.

These regulations, moreover, took effect only a year before the Budget Act,[21] and did not interfere with EAC's ability to live up to its obligations or its capacity to operate. They did not require EAC to give up resources that it had set aside to meet its existing obligations. They were no more burdensome than existing restrictions to which EAC had agreed (in contracts with the state and its secondary market) and under which it had operated since 1979. (Bishop Aff., Exs. B, W)

Indeed, the Court of Appeals went so far as to suggest that assets held by private entities pursuant to such regulations are held in trust for the "general public." Pet. App. 19a. Nothing in this Court's constitutional jurisprudence warrants such a result. *Dayton-Goose Creek Ry. v. United States*, 263 U.S. 456 (1924), relied on by the court below, surely does not.

The statute involved in *Dayton-Goose Creek*[22] expressly

[21]51 Fed. Reg. 40,902 (Nov. 10, 1986). Before November 1986, if a guaranty agency elected to enter into a contract to receive advances from the Secretary, it had to agree to restrictions similar to those generally imposed by the 1986 regulations. 45 C.F.R. §§ 177.403(f); 177.404(e) (1980); 45 C.F.R. § 177.24 (1978). The guaranty agency, however, *always* had the option to repay the advances and avoid the contractual limitations. The Secretary's own affidavits confirm that before the 1986 regulations there were few federal limitations on guaranty agencies' ability to use their cash reserves for any purpose, *including purposes totally unrelated to the GSL Program.* (Newman Aff., Ex. 1, pp. 4, 32-38) Guaranty agencies not only could expect to use the money in their reserves for non-GSL Program purposes, numerous agencies (not including EAC) did. (*Id.*)

[22]Transportation Act of 1920, ch. 91, § 422, 41 Stat. 456, 489-91. Relevant portions of the statute are summarized in the case syllabus. 263 U.S. at 456-57.

and unambiguously imposed a trust on certain railroad earnings. *Id.* at 476-77. Nothing in the Act either explicitly (or even implicitly) imposes a trust on guaranty agency reserves. More importantly, the statutory requirement in *Dayton-Goose Creek* that the railroads hold a specified portion of their income in trust was prospective only.

In the proceedings below, the Secretary argued that *Dayton-Goose Creek* stands for the proposition that "entities engaged in public service operations, such as railroads, have no property rights to 'excess' income, so there can be no Fifth Amendment 'taking' of such income." (Defendant's Brief in Opposition to Motion for Summary Judgment, p. 29). This Court made no such holding in that case. Rather, it held that when Congress, legitimately exercising its ratemaking authority over railroads in the immediate post-World War I period, gave *advance* notice that a portion of the earnings of certain profitable roads would be held in trust for certain purposes, those earnings were in fact held in trust and did not, *for that reason*, become the property of the affected railroads. 263 U.S. at 484. The Court of Appeals' apparent acceptance of the broader, unsupportable proposition advanced by the Secretary is both wrong and sufficiently dangerous to require correction from the only Court with power to give it.

B. Neither the "Subsequent Changes" Clauses in the Contracts nor Previous Amendments to the GSL Program Deprived EAC's Property of Constitutional Protection.

The "subsequent changes" clauses in EAC's contracts with the Secretary are no more than an acknowledgement that Congress (or the Secretary, if acting under properly delegated authority) may make *prospective* changes in the relationship between the parties. They cannot be interpreted to render the primary undertaking of the Secretary illusory. *See, e.g., Torncello v. United States*, 681 F.2d 756 (Ct. Cl. 1982) (en banc) ("termination for convenience of the Govern-

ment" clause cannot be read to vitiate the Government's contractual commitment). Such a pedestrian provision cannot avoid this Court's admonitions to Congress in such cases as *Lynch* (where the policy contained a "subsequent changes" clause, 292 U.S. at 577), that the Government must abide by its promises.

To read the "subsequent changes" clause to mean that Congress (or the Secretary) can take away the basic right provided in the contracts, as to loans that have already been made and guaranties that have already been issued, is to render the contracts, and the security they provide, illusory. Such an interpretation would just as readily allow Congress to amend the Act to eliminate all reinsurance on loans previously insured by EAC. These clauses cannot mean that EAC's reserves are not "property."

The only interpretation of the clause that makes sense and conforms to governing principles of interpretation is that the right to receive reinsurance payments cannot be modified by subsequent statutory or regulatory amendments unless EAC agrees. These subsequent amendments apply "in accordance with their effective dates" (Reinsurance Contract, ¶1) and can only apply to loans guaranteed after the effective date, unless EAC consents to broader application, as, for example, by continuing to participate in the program after the effective date of an amendment purporting to apply to loans already insured.

Not only does this construction avoid rendering the Reinsurance Contract illusory, it also reads it in light of its context and the reinsurance purpose it is to serve and consistently with the rest of the contracts. Along with the Act, 20 U.S.C. § 1078(c)(1)(A) (Pet. App. 48a-49a) (EAC has a "contractual right against the United States, during the life of [each] loan, to receive reimbursement . . ."), those other provisions show that the Government intended to remain bound by outstanding reinsurance commitments even if the Secretary's reinsurance authority were to expire or if the Reinsurance Contract were to be terminated.

A continuing commitment on outstanding guaranties was, of course, essential if EAC, the secondary market maker, and lenders were to be attracted to the GSL Program. One party's imposing new "conditions" on his performance after the other party has performed by binding itself to third parties would not only make the contract illusory, it would transform the Secretary's imposed contract forms into the very "bait and switch" devices that the District Court correctly thought "probably would constitute a failure of consideration, a breach of contract, and a violation of the fifth amendment takings and due process clauses." (Pet. App. 44a) It belies common sense to suggest that parties entering into a reinsurance relationship could have intended this.[23] EAC's construction permits the Reinsurance Contract to serve its "reinsurance" purpose. The Secretary's interpretation does not.

The Court of Appeals also thought it constitutionally significant that EAC had previously accepted changes in the Act and in the regulations that had an adverse impact on its reserve fund balance (Pet. App. 19a-20a).[24] But this point really begs the question, for EAC has not accepted the Budget Act amendments. If it has any significance at all in the Fifth Amendment analysis, EAC's accession to prior amendments should be seen as an act of dominion, fully consistent with ownership of its assets. Regardless of that, no prior

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[23]Insurance contracts are to be given that construction "which a reasonable person in the position of the insured would have understood the language used to mean." 2 R. Anderson, *Couch on Insurance 2d* § 15:16 (rev. ed. 1984) (citations and footnotes omitted).

[24]The court referred to the adoption in 1986, Pub. L. No. 99-498, § 402, 100 Stat. 1268, 1380, of a *prospectively* assessed reinsurance fee and regulations promulgated the same year strengthening due diligence requirements for loan collection. 34 C.F.R. §§ 682.402, 682.410, 682.411. These "new" due diligence requirements (many of which were directed to lenders rather than guaranty agencies) did not impose significant financial or administrative burdens on EAC.

consent to regulation can serve to deprive EAC of the right to resist a wholesale confiscation of over two-thirds of its resources.

II. THE COURT OF APPEALS HAS MISAPPLIED THIS COURT'S DECISION IN *BOWEN*.

Just as Congress may not seize EAC's reserves, it may not abrogate the Secretary's reinsurance obligation by making it conditional upon turnover of these reserves. In *Bowen*, 477 U.S. 41 (1986), this Court addressed the unique situation of Congress's ability to change its mind about a statutory and contractual commitment it had made to the states at the very beginning of the Social Security program about the states' ability, as employers, to take their employees out of the system. A number of things had changed in the intervening years. First, this Court's decisions on intergovernmental immunity had made clear that the states were not constitutionally entitled to an exemption, contrary to the concern in 1935. *Id.* at 44 n.4. Second, the number of states that had exercised their option to withdraw had reached the stage where Congress was concerned about the system's integrity if the right to withdraw continued to be recognized. *Id.* at 46-47.

Under these circumstances, this Court held that Congress, which had expressly reserved the right to repeal the statutory provision under which the states' contractual right to withdraw was recognized, was not prevented by the Fifth Amendment from enacting the repeal. The Court emphasized not only the express reservation of the right to amend (not present here), but Congress's right as the sovereign to respond to "ever-changing conditions" affecting a social welfare program. *Id.* at 51-52.

In *Bowen*, the Court reaffirmed its historic position that Congress cannot "take away property already acquired under the operation of the charter, or . . . deprive [a contracting

party] of the fruits actually reduced to possession of contracts lawfully made." *Id.* at 55, citing *Sinking-Fund Cases*, 99 U.S. 700, 720 (1879). It concluded, however, that the states' "contractual right" to withdraw from the Social Security Program was not "property," for it was "neither a debt of the United States . . . nor an obligation of the United States to provide benefits under a contract for which the obligee paid a monetary premium . . . ." 477 U.S. at 55. Observing that the termination clause was not a term over which the states had any bargaining power or for which they had provided independent consideration, the Court said that the clause did not rise to the level of a vested right. *Id.*[25]

By contrast, the Secretary's commitment to pay reinsurance to EAC on insured loans is at the very heart of their agreement. It was the essence of the bargain between them, for which EAC paid independent consideration in the form of an executed promise to guarantee loans and administer its insurance program and, since 1986, in the further form of a reinsurance fee. The Secretary's fulfillment of that commitment cannot now be conditioned on EAC's compelled relinquishment of the very assets that it has pledged[26] to support its obligations and that constitute the only source of money it has to meet them.

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[25]Although executory, EAC's right to reimbursement from the Secretary is vested, for rights under an executory contract become binding when promises are exchanged. Restatement (Second) of Contracts §§ 17, 18, 75 (1981). Specifically, reinsurance rights become binding on the reinsurer when, in reliance on the promise to reinsure, the reinsured party issues the "original" insurance, in this case to the lenders. *See* 9 R. Anderson, *Couch on Insurance 2d* § 39:123 (rev. ed. 1985).

[26]EAC entered into guaranty reserve agreements ("GRAs") with its secondary market maker to permit it to obtain funds to purchase EAC-guaranteed loans. EAC bound itself to maintain a guaranty fund equal to at least 2% of the unpaid principal amount of all its outstanding guaranties. The GRAs prohibit EAC from using its guaranty fund for any purpose other than (a) the pay-

(footnote continued on next page)

The critical distinction between reserving the right to make prospective changes and claiming the right to apply amendments retrospectively is reflected in the language of the Higher Education Act itself. The Act, in sharp contrast to the Social Security Act at issue in *Bowen*, does not reserve a right to repeal or alter the reinsurance provisions at issue here. Pet. App. 22a. Rather, the 1986 amendments clarified the existence of contractual rights to reinsurance in guaranty agencies *during the life of the loan*. 20 U.S.C. § 1078(c)(1)(A) (Pet. App. 48a-49a). When Congress wished to retain the right to revoke reinsurance rights in the Higher Education Act, it did so explicitly.[27]

Construing the contracts to prohibit the Secretary from withdrawing his reinsurance commitment on existing loans (and holding Congress to that construction) does not "effectively . . . forbid Congress to amend" the Act, as the lower court decision in *Bowen* would have done, and does not restrict its right to respond to "ever-changing conditions" affecting a social welfare program. 477 U.S. at 51-52. EAC's claim is quite unlike that made by the states in *Bowen*, which argued that Congress could never require their participation in the Social Security Program. Congress is free to end the GSL Program. It can still alter the terms upon

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ment of claims; (b) the return of federal advances; or (c), to the extent the fund balance exceeds the required minimum, the payment of expenses of administering its guaranty program. The security provided by the GRAs' restrictions made it possible for the secondary market maker to raise money in the bond market. Because of those restrictions, the bondholders can rely on the security provided by EAC's guaranty fund. (Bishop Aff., ¶¶19, 20, Ex. W)

[27]The Act provides that guaranty agencies will receive 100% reinsurance during their first five years of operations, regardless of the claims rate. 20 U.S.C. § 1078(c)(7). The same section explicitly provides, however, for revocation of the application of this provision (*i.e.*, ignoring the effect of claims rate on reinsurance amount) if the Secretary determines that an agency has not exercised reasonable prudence.

which the Secretary may make new reinsurance commitments. It is only foreclosed from rescinding the promises it has already made or authorized the Secretary to make as to existing guaranties.

The Court of Appeals has perverted the holding in *Bowen* into a rule that Congress always has the right, in dealing with a program that can be characterized as advancing the "social welfare" (as most congressional programs can be) "to impose additional requirements . . . not contemplated" in an entity's agreements with the Government (Pet. App. 23a). While the court acknowledged a limitation recognized in *Perry* and springing from the *Sinking-Fund Cases*, 99 U.S. 700 (1879), that Congress may not use the power of amendment to repudiate its own debts, *Perry*, 294 U.S. at 350-51, it made hash of the limitation by finding it not implicated when the amendment mandates the surrender of most of the private entity's assets and makes it incapable of meeting its financial obligations.[28]

The Court of Appeals blandly described the Budget Act amendments, as "merely add[ing] to the numerous statutory and regulatory requirements with which a guaranty agency must comply." Pet. App. 25a. These "mere" regulatory requirements, however, compelled EAC to give the Secretary virtually everything it had. By the same sophistry, a person relinquishing money with a gun at her head would be the victim, not of robbery, but of "mere" regulation. This cannot be the extent of Fifth Amendment protection of private

[28]Many private entities supply goods and services to governmental bodies for use in "social welfare" programs. Under the Court of Appeals' construction of *Bowen*, Congress and state legislatures are free to avoid paying for those goods and services if they characterize the supplier's forgiveness of the debt as an "additional requirement" under the contract.

property from government taking,[29] and this Court should say that it is not.

[29]Nor is it conclusive, for purposes of constitutional analysis, that Congress declared the seized funds "excess," or, as the Court of Appeals put it, "not necessary to the continued functioning of the agency." Pet. App. 24a. The District Court found it "largely uncontroverted . . . that EAC will encounter difficulty in meeting its obligations" because of the seizure. Pet. App. 37a. A legislative declaration of fact cannot foreclose constitutional challenge in the courts to a legislative act of seizure. *Chastleton Corp. v. Sinclair*, 264 U.S. 543, 547 (1924) (". . . a Court is not at liberty to shut its eyes to an obvious mistake, when the validity of the law depends upon the truth of what is declared"). *Cf. Landmark Communications, Inc. v. Virginia*, 435 U.S. 829, 843-44 (1978); *McLaughlin v. Florida*, 379 U.S. 184, 191-92 (1964).

CONCLUSION

In sum, while paying lip service to the Fifth Amendment principles this Court has long upheld, the Court of Appeals has completely undercut their practical import and left the property of private entities involved in some way in government programs subject to seizure at whim. That a respected court could come to that conclusion in the face of a barely disguised confiscation of private property is ample showing of the importance of the issue presented by this petition. EAC respectfully requests that this Court issue its writ of certiorari to review and reverse the judgment of the Court of Appeals.

Dated this 9th day of July, 1990.

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 89-5393

Education Assistance Corporation, A South Dakota Corporation,

Appellant,

v.

Lauro F. Cavazos, Secretary of Education of the United States,

Appellee.

Appeal from the United States District Court for the District of South Dakota

Submitted: December 15, 1989
Filed: April 10, 1990

Before McMILLIAN, JOHN R. GIBSON and BOWMAN, Circuit Judges.

McMILLIAN, Circuit Judge.

The Education Assistance Corporation (EAC) appeals from a final order entered in the United States District Court[1] for the District of South Dakota granting summary judgment in favor of the Secretary of the United States Department of Education (Secretary). For reversal, EAC argues (1) the 1987 amendments to the Higher Education Act of 1965 violate its property rights under the fifth amendment by requiring EAC to transfer $6.6 million of "excess cash reserves" to the Secretary and by conditioning EAC's right to reimbursement on compliance with that requirement and (2) the Secretary's denial of EAC's request for a waiver from the transfer requirement was arbitrary and capricious. We affirm.

[1]The Honorable Donald J. Porter, Chief Judge, United States District Court for the District of South Dakota.

I.

In 1965 Congress enacted the Higher Education Act, Pub. L. No. 89-329, 79 Stat. 1232 (1965) (codified as amended at 20 U.S.C. §§ 1071 *et seq.*) (the Act), which established a guaranteed student loan (GSL) program to assist students in financing their post-secondary education. The Act encourages state agencies or, in their stead, private non-profit corporations known as guaranty agencies to establish student loan guaranty programs by providing federally-subsidized interest payments and by authorizing the Secretary to reinsure guaranteed loans. 20 U.S.C. § 1071(a)(1) (1988).

EAC, formerly known as South Dakota Education Assistance Corporation, was organized as a non-profit corporation in 1978 and designated by the Governor of South Dakota as South Dakota's guaranty agency. On November 14, 1978, EAC entered into four contracts with the Secretary's predecessor, the Commissioner of Education (hereinafter the Secretary). The "basic contract" recognizes EAC as South Dakota's guaranty agency and provides that lenders who receive EAC's guaranty will also receive a federal interest subsidy. *See* 34 C.F.R. § 682.401 (1988). The "advances contract" entitles EAC to receive cash advances from the Secretary pursuant to 20 U.S.C. § 1072(a)(1) (1988) and 34 C.F.R. § 682.403 (1988).[2] The two remaining contracts are the heart of the GSL program. They obligate the Secretary to reimburse EAC for payments it makes in discharge of its guar-

[2]These advances were authorized by Congress to enable new agencies to commence operations. 20 U.S.C. § 1072(a)(1) (1988). The Act gives the Secretary the discretion to set the terms and conditions of payment. 20 U.S.C. § 1072(a)(3)(1988). The Secretary is directed to seek repayment of these advances whenever appropriate in light of the maturity and solvency of the reserve fund for which the advance was made. *Id.* EAC's advances contract provides that the Secretary shall not require repayment until the sum of the advances exceeds 20% of EAC's outstanding insurance obligation. As of September 1988, EAC had received $2,291,918 in advances pursuant to its advances contract. All of this money had been paid by the Secretary prior to 1984.

anty obligations when a student defaults on a loan. EAC's original "reinsurance contract" provided for reimbursement of 80% of the amount expended by EAC in discharge of its insurance obligations. *See* 34 C.F.R. § 682.404 (1988). The "supplemental reinsurance contract" binds the Secretary to reimburse EAC for 100% of the amount paid to lenders as long as EAC's default rate does not exceed 5% of the loans insured by EAC. *See* 34 C.F.R. § 682.405 (1988). If the default rate rises to between 5% and 9%, EAC receives 90% reimbursement. *Id.* If the default rate exceeds 9%, EAC only receives 80% reimbursement. *Id.*

The contracts obligate EAC to comply with the statutory and regulatory requirements of the GSL program and "all changes in the Act or regulations in accordance with their respective effective dates."[3] They also give the Secretary permission to withhold reimbursements owing to EAC if "the [Secretary] finds that . . . there has been a failure by [EAC] to comply with any of the provisions of this Agreement or applicable Federal law or regulations."[4]

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[3] This language is included in the basic contract and the reinsurance contract.

[4] The following language is included in all four of EAC's contracts with the Secretary:

> If the [Secretary] finds that any of the assurances or representations made by [EAC] in connection with this Agreement are incomplete or incorrect in any material respect or that there has been a failure by [EAC] to comply with any of the provisions of this Agreement or applicable Federal law or regulations, [the Secretary] may take such action short of termination as may be necessary to protect the interests of the United States. Such action may include withholding payments to be made to [EAC] until adequate documentation therefor is provided or requiring that [EAC] reimburse the [Secretary] for any payments made, or any payments which the [Secretary] has become obligated to make, as a result of [EAC's] making such incomplete or incorrect statements or violating such provisions of this Agreement or applicable Federal law regulations.

EAC's assets are held in a "reserve fund." *See* 34 C.F.R. § 682.410(a)(1) (1988). The assets include federal advances, reimbursements, and administrative cost allowances. Administrative cost allowances are paid by the Secretary to EAC pursuant to 20 U.S.C. § 1078(f) (1988) to help offset EAC's operating costs. In 1986, Congress made these allowances mandatory and gave the guaranty agencies a "contractual right" to receive them. Higher Education Amendments of 1986, Pub. L. No. 99-498, 100 Stat. 1268, 1381 (codified as amended at 20 U.S.C § 1078(f)(1)(A) and (f)(1)(B) (1988)) (hereinafter 1986 Amendments). At the same time Congress confirmed that guaranty agencies have a "contractual right" to reimbursements from the Secretary. 1986 Amendments, 100 Stat. at 1376 (codified as amended at 20 U.S.C. § 1078(c)(1)(A) (1988)). EAC's reserve fund also consists of a single insurance premium not exceeding 3% of the loan, which is paid by the lender and passed on to the student borrower, and a portion (currently not greater than 30%) of the amount collected by an agency from a borrower after default on a loan for which the agency's claim was reimbursed by the Secretary. *See* 20 U.S.C. § 1078(b)(1)(H), (c)(2)(D), (c)(6)(A)(ii) (1988). EAC recently stopped charging lenders the 3% insurance fee in an effort to entice lenders to the program. EAC also is entitled to investment earnings on the reserve fund. *See* 20 U.S.C. § 1072(c)(3) (1988). Neither the State of South Dakota nor private investors have contributed to EAC's reserve fund.

In 1987 Congress amended the Act by adding 20 U.S.C. § 1072(e) (1988), the constitutionality of which is at issue in this case. The 1987 amendments, enacted as part of the Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 3001, 101 Stat. 1330, 1330-36 (1987), limit the amount of cash reserves a state or guaranty agency may maintain in its reserve fund. They were adopted after the Comptroller General reported to Congress that guaranty agencies had built up unnecessarily large cash reserves and some were using the funds for non-GSL purposes. *See* H.R. Conf. Rep.

No. 495, 100th Cong., lst Sess. 518, *reprinted in* 1987 U.S. Code Cong. & Admin. News 2313-1264 (hereinafter 1987 USCAAN). The amendments require the Secretary to determine a maximum cash reserve for each agency using fiscal year 1986 financial data and to recover the amount of reserves in excess of that maximum amount.[5] 20 U.S.C. § 1072(e)(1), (e)(2) (1988). An agency may transfer its excess reserves to the Secretary by any one of four methods: (1) repaying advances not otherwise required to be repaid, (2) withholding and cancelling claims for reinsurance otherwise payable, (3) reducing claims for administrative cost allowances, and (4) any other acceptable method such as a lump sum payment or the payment of additional reinsurance fees. 20 U.S.C. § 1072(e)(2). The total cash reserves recovered by the Secretary may not exceed $250 million, 20 U.S.C. § 1072(e)(4) (1988), and have been deposited in the student loan insurance fund established under the Act. The student loan insurance fund is used to reimburse guaranty agencies for defaulted loans. *See* 20 U.S.C. § 1081(a) (1988). The 1987 amendments expired automatically on September 30, 1989. Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 3002, 101 Stat. 1330, 1330-38.

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[5] An agency's maximum cash reserve is determined by the greater of:

> 40 percent of the total amount paid by that agency on insurance claims during the preceding fiscal year;
>
> 0.3 percent of original principal amount of loans that are insured by that agency and that are outstanding at the end of such preceding fiscal year;
>
> an amount which, when combined with all other parts of total agency reserves, equals 0.4 percent of such original principal amount;
>
> $500,000; or
>
> the amount required to comply with the reserve requirements of a State law as in effect on October 17, 1986.

20 U.S.C. § 1072(e)(1) (1988).

A guaranty agency may request a waiver from the transfer requirement pursuant to 20 U.S.C. § 1072(e)(3) (1988). The Secretary is authorized to grant a waiver if (1) the agency's financial position has deteriorated significantly, (2) significant changes in economic circumstances or in the loan program render the agency's maximum cash reserve inadequate, or (3) the transfer would compel an agency to violate contractual obligations that require the agency to maintain a specified level of reserve funds. 20 U.S.C. § 1072(e)(3).

On December 22, 1987, EAC notified the Secretary that it considered the 1987 amendments to be an abrogation of the Secretary's contractual obligations and that it would not consent to incorporation of the transfer requirement into its existing contracts with the Secretary. To avoid any implication that it consented to the transfer requirement, EAC announced it would not guarantee any student loans after December 21, 1987. To ensure continued access to loans for the students in South Dakota, EAC arranged for the Pennsylvania Higher Education Assistance Agency to guarantee those loans which EAC would otherwise have guaranteed. On January 25, 1988, the Secretary suggested that EAC apply for a waiver rather than suspend its guaranty function. The Secretary also warned EAC that suspension of its guaranty obligations constituted a termination of the existing agreements and that the Secretary would accordingly not reinsure any loans guaranteed by EAC on or after December 21, 1987.

Meanwhile, the Secretary determined that EAC's reserve fund balance in fiscal year 1986 contained $6.6 million in excess of its maximum cash reserve calculated pursuant to 20 U.S.C. § 1072(e)(1)(A). In a letter dated February 16, 1988, the Secretary directed EAC to choose a method of transferring the $6.6 million excess cash reserves to the Secretary or request a waiver pursuant to 20 U.S.C. § 1072(e)(3).

On March 15, 1988, EAC requested a waiver from the transfer requirement. In support of its request, EAC sub-

mitted a study conducted by the accounting firm of Touche Ross & Co. which concluded that, without the $6.6 million, EAC's reserve fund would not be adequate to meet EAC's future insurance obligations. EAC also claimed that the transfer requirement would compel it to violate the minimum reserve balance it promised to the South Dakota Student Loan Corporation (SDSLC). SDSLC is a non-profit corporation, established in 1978, which operates a secondary market for student loans by purchasing the loans from private lenders. On September 26, 1988, the Secretary denied EAC's request for a waiver. EAC refused to transfer the $6.6 million to the Secretary, and the Secretary began withholding reimbursements on claims submitted by EAC for payments it made in discharge of its insurance obligations. By the time this appeal was taken, the Secretary had recovered the full $6.6 million.

EAC commenced this action on December 12, 1988, seeking a declaration that the Secretary's refusal to pay $6.6 million in reimbursement claims constituted a breach of contract and that the 1987 amendments deprived EAC of property without due process of law in violation of the fifth amendment. EAC also requested a money judgment for $6.6 million, the amount of the unpaid claims. EAC's third cause of action sought review of the Secretary's denial of EAC's waiver request. The parties filed cross-motions for summary judgment on all three causes of action, and the district court granted summary judgment for the Secretary. The district court held that the transfer requirement does not effect a "taking" without just compensation, that the Secretary did not breach its contract with EAC, and that the Secretary's denial of EAC's waiver request was not arbitrary or capricious. This appeal followed.

II.

We begin with the Secretary's denial of EAC's request for a waiver because resolution of that issue in EAC's favor

would preclude discussion of EAC's constitutional claim. See *Jean v. Nelson*, 472 U.S. 846, 854 (1984) (prior to reaching any constitutional questions, federal courts must consider non-constitutional grounds for decision). Our review of the Secretary's action is governed by the Administrative Procedure Act, 5 U.S.C. § 706 (1988), which authorizes us to set aside agency actions, findings, and conclusions if they are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). Our standard of review is a narrow one, deferential to the agency's interpretation of its own regulations and only permitting reversal if the agency action is without a rational basis. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42-43 (1983) *(Motor Vehicle); Moore v. Custis*, 736 F.2d 1260, 1262 (8th Cir. 1984). While we may give deference to the agency's interpretation of the statute which gives it the authority to act, *Udall v. Tallman*, 380 U.S. 1, 16 (1965), we have ultimate responsibility over questions of statutory interpretation and Congressional intent. *See* 5 U.S.C. § 706. We review the district court's decision upholding the Secretary's action *de novo*, and we base our *de novo* review on the administrative record that was before the district court. *Moore v. Custis*, 736 F.2d at 1262. After careful review of the administrative record and EAC's arguments on this issue, we hold that the Secretary's denial of EAC's request for a waiver was not arbitrary or capricious.

A.

Title 20 U.S.C. § 1072(e)(3)(A)(ii) authorizes the Secretary to grant a waiver if "significant changes in the economic circumstances (such as a change in agency current cash reserves) or the loan insurance program render the [reserve fund] limitations inadequate for the continued functioning of the agency." In support of its request for a waiver under this provision, EAC submitted a report prepared by Touche Ross analyzing the adequacy of EAC's reserves as of September 30, 1987, and the impact of the transfer requirement

on EAC's ability to meet its financial obligations over the next fifteen years. EAC also submitted its financial statements for fiscal years 1986 and 1987. Touche Ross concluded that EAC's reserve balance after transferring $6.6 million to the Secretary would not be adequate to meet EAC's future guaranty obligations.

Without addressing the Touche Ross report, the Secretary found that EAC "failed to demonstrate that it experienced a significant change in economic circumstances." The Secretary relied on EAC's financial statements which indicated that EAC's financial strength had improved during fiscal year 1986.[6] The Secretary also reviewed EAC's financial data from fiscal year 1987. If application of the statutory formula in 20 U.S.C. § 1072(e)(1)(A) to fiscal year 1987 had resulted in a lesser excess cash reserve amount than that previously determined for fiscal year 1986, the Secretary was prepared to waive the larger amount and apply the transfer requirement to EAC's fiscal year 1987 reserve fund balance. After calculating 40% of the total amount paid by EAC on insurance claims in fiscal year 1987 and subtracting that figure from EAC's total cash reserves for fiscal year 1987 less the amount of advances owing to the Secretary, the Secretary calculated excess cash reserves of over $8 million, $2 million above that calculated for fiscal year 1986. The Secretary therefore concluded that EAC had not experienced a change in economic circumstances warranting a waiver of some or all of the $6.6 million in excess cash reserves for fiscal year 1986.

EAC argues that the Secretary's "narrow" reading of the waiver provision is contrary to Congressional intent as expressed in the House Conference Report and the statute.[7]

[6]EAC's reserve fund balance increased from $6,846,606 on September 30, 1986, to $7,184,831 on September 30, 1987.

[7]The Conference Report states:

> The agency's appeal may be based on a deterioration of finan-

(Footnote continued on following page)

See 1987 USCAAN at 2313-1264 to 65. We disagree. We do not think Congress necessarily intended the Secretary to grant relief to an agency in EAC's financial position.[8] Congress adopted four alternative formulas for determining an agency's maximum cash reserve, formulas it believed would

(Footnote continued from previous page)

> cial position or significant changes in economic circumstances or its loan program which render the reserves, as limited by the bill, inadequate for continued functioning of the agency. The Managers expect that that the Secretary will broadly exercise the authority to waive the requirement in order to prevent damage to the functioning of the guaranty agency.
>
> For example, the Managers do not intend that the Secretary shall only grant relief if the agency would be forced to cease operations; such a narrow interpretation would not be in keeping with the intent of the Managers. The Secretary must assess whether reduction of cash reserves would materially affect the agencies; [sic] current and future ability to perform their vital role as the guarantors of student loans. The Secretary should consider such factors as . . . composition of current and probable future student populations served by the guarantor, changes in sources of funds which diminish the guaranty agency's ability to have sufficient resources to meet lender's claims . . . . The Managers expect that in assessing appeals by guaranty agencies the Secretary will take into account their most recent available certified financial statements. The Managers wish to stress it is not the intention of the Congress to either materially harm an agency's ability to fulfill its function in the guaranteed student loan program or to so financially weaken an agency so as to impair its function.

H.R. Conf. Rep. No. 495, 100th Cong. 1st Sess. 518-19, *reprinted in* 1987 U.S. Code Cong. & Admin. News 2313-1264 to 65.

[8]EAC certified to the Secretary that at the end of fiscal year 1988, it had cash reserves of $9,907,721 and total reserves (including receivables) of $11,057,749. At the same time, EAC's cumulative unreimbursed claims payments since 1978 when it first entered the program were $945,601. Reducing EAC's cash reserves by $6,607,592 would leave it with $3,300,129 or three times more than what it needed to pay unreimbursed claims over an 11-year period.

allow most agencies to continue to meet their financial obligations under the GSL program. *See* 20 U.S.C. § 1072(e)(1).[9] Congress provided for a waiver of the cash reserve limitation in three narrow circumstances. 20 U.S.C. § 1072(e)(3). While making clear that it did not want to "materially harm an agency's ability to fulfill its guaranty function," Congress gave the Secretary discretion to determine, on a case-by-case basis, when and to what extent waiver is necessary to prevent that harm from occurring. 1987 USCANN at 2313-1264.

The language of the particular waiver provision at issue here requires that EAC not only show that its maximum cash reserve balance is inadequate, but also that "a change in economic circumstances" renders it so. 20 U.S.C. § 1072(e)(3)(A)(ii). The Secretary's finding that EAC demonstrated no change in economic circumstances is supported by the record. EAC's financial statements show that its reserve fund increased rather than decreased over the course of fiscal years 1986 and 1987. That the Secretary did not address the Touche Ross report in its denial letter does not render the denial arbitrary or capricious because the Secretary's explanation for its decision, namely that EAC had not demonstrated a change in economic circumstances, does not run

[9]These formulas were based on the Comptroller General's report to Congress and a follow-up report by the General Accounting Office (GAO) establishing specific guidelines for reducing guaranty agency reserves without jeopardizing the cash flow the agency needs to meet expenses and guaranty obligations. The GAO based its cash flow analysis on a survey of agencies' recent default claims, and the reserve levels were developed to provide adequate reserves for agencies with the largest negative cash flows. Seventeen of the agencies analyzed experienced negative cash flows during either fiscal year 1984 or 1985, and were required to draw on reserves to meet expenses. The GAO found, however, that eight of the seventeen agencies could have offset further negative cash flows by increasing insurance premiums charged to lenders. Although in the past EAC charged lenders a 3% insurance premium, it recently discontinued this practice in an effort to recruit lenders.

counter to the findings of the Touche Ross report. *See Motor Vehicle,* 463 U.S. at 43. The Touche Ross report demonstrates no change in economic circumstances not already taken into account by the Secretary and Congress in calculating EAC's maximum cash reserve level. The report was aimed at quantifying the level of reserves required for EAC to meet the future reserve requirements of its loan portfolio and at determining whether EAC's reserve balance remaining after $6.6 million is transferred to the Secretary is adequate to meet EAC's future obligations. The report's conclusions merely contradict GAO's assessment, relied upon by Congress in calculating an agency's maximum cash reserve balance, of what reserve level is adequate for the continued functioning of the guaranty agency.[10] We agree with the district court that Congress did not intend to require the Secretary to reformulate for each individual guaranty agency a maximum cash reserve level. Congress intended the waiver provision in 20 U.S.C. § 1972(e)(3)(A)(ii) [*sic*] to apply only if circumstances arose after the GAO analysis that rendered GAO's calculations inadequate. We therefore hold that the Secretary's denial of a waiver under § 1072(e)(3)(A)(ii) was not arbitrary or capricious.

B.

Congress also directed the Secretary to consider the guaranty agency's existing contractual obligations and to grant a waiver if, in transferring reserve funds, a guaranty agency would be compelled to violate a contractual obligation that requires the agency to maintain a specified level of reserve funds. 20 U.S.C. § 1072(e)(3)(A)(iii). In support of its request for a waiver under this provision, EAC submitted to

[10]For instance, Touche Ross based its study on a different set of assumptions than did GAO, taking issue with GAO's assumption that future revenue is expected to cover the expenses of prior paid loans. Touche Ross instead matched revenue for new loans with future expenses associated with these loans, which it claimed is consistent with generally accepted accounting principles.

the Secretary a copy of four Guaranty Reserve Agreements (GRAs) in force between EAC and SDSLC.[11] The Secretary found that the transfer requirement would not compel EAC to violate any of its obligations under the GRAs. EAC argues that the Secretary's interpretation of the language contained in each GRA regarding a minimum reserve fund balance is incorrect and that the transfer requirement would compel EAC to violate that language. We disagree.

The Secretary's interpretation of EAC's contractual obligations is adequately supported by the language contained in sections 5(i) and (ii) of each GRA, and therefore the Secretary's denial of EAC's request for a waiver under § 1072 (e)(3)(A)(iii) was not arbitrary or capricious. The Secretary noted that GRA § 5(i) requires EAC to maintain in its reserve fund at least 2% of the unpaid principal amount of all student loans it insures *or* such lesser amount as agreed to by the indenture trustee.[12] EAC argues that the Touche Ross report negates any possibility that the trustee would agree to a reserve fund below 2% of the unpaid principal of

[11]Each GRA was entered into on a different date in connection with separately secured issues of SDSLC's student loan revenue bonds, publicly offered and distributed.

[12]GRA § 5(i) specifically states:

> The Guarantee Fund shall be maintained at a minimum amount (hereinafter called the "Required Minimum Amount") as of any date of calculation equal to (A) two percent (2%) of the unpaid principal amount of all student loans insured or guaranteed by EAC, or (B) such lesser amount agreed to by the Trustee in writing, after the Trustee has examined the report of a firm of independent certified public accountants reasonably acceptable to the Trustee stating that, based on reasonable and appropriate assumptions, EAC will have sufficient cash available to carry out its guarantee function for so long as any Bonds remain Outstanding and Financed Student Loans are Guaranteed by EAC, and that the Guarantee Fund will be sufficiently funded at such Required Minimum Amount to cover the reasonably expected obligations of EAC on defaulted student loans guaranteed or insured by it.

all loans insured. The Secretary responds that whether the indenture trustee would have relied on the Touche Ross projections is purely speculative, and, therefore, the Touche Ross report cannot serve as a basis for finding that the transfer requirement would *compel* EAC to violate its obligations under the GRAs. We agree with the Secretary.

The Secretary's finding that EAC would not be compelled to violate obligations owing to SDSLC is further supported by GRA § 5(ii). This section provides that EAC may only use the reserve fund for the purpose of fulfilling its guaranty obligations, including the repayment of any federal advances required by the Secretary. It further provides that if such use reduces the reserve fund below the two percent minimum, EAC shall take all steps necessary to restore the fund as rapidly as practicable.[13] EAC contends that satisfying the transfer requirement is not a permitted use of its reserve fund under GRA § 5(ii) because it constitutes neither the repayment of federal advances nor the fulfillment of EAC's obligations "upon its guarantee or insurance of stu-

[13]GRA § 5 (ii) specifically states:

> The Guarantee Fund may be used by EAC solely and only for the purpose of, at any time, permitting it to fulfill its obligations (including the repayment of any advances from the federal government) upon its guarantee or insurance of student loans, including Financed Student Loans, and, if such use reduces the amount then on deposit in the Guarantee Fund to less than the then applicable Required Minimum Amount, EAC shall promptly take all steps necessary to restore the amount then on deposit in the Guarantee Fund to not less than the Required Minimum Amount as rapidly as is practicable under the circumstances then in existence. Such steps shall include, but not be limited to, continuation or imposition (beginning with the next academic year) of premiums on the guarantee or insurance of student loans at a reasonable rate, which will be sufficient to cure, at the earliest practicable date, any deficiency not covered by the application of other moneys available to EAC, and the retention of all earnings on and income from the investment of amounts on deposit in the Guarantee Fund.

dent loans." We do not believe the language in GRA § 5(ii) is so limited. We agree with the district court that the permitted uses under GRA § 5(ii) encompass all obligations under the Act, including the transfer requirement in 20 U.S.C. § 1072(e)(2). The Secretary's interpretation of GRA § 5(ii) as allowing EAC to dip below the 2% minimum in order to satisfy the transfer requirement, as long as it takes all practicable steps to replenish the fund, is rational and not arbitrary or capricious.

III.

We turn now to the constitutional issue presented: whether the 1987 amendments to the Higher Education Act effect a taking of property without just compensation or a deprivation of property without due process of law within the meaning of the fifth amendment.[14] For the reasons discussed below we find that they do not.[15]

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[14]EAC's constitutional claim was plead under the due process clause of the fifth amendment. In its motion for summary judgment, EAC argued that the Secretary's actions constitute a "taking" without just compensation in violation of the fifth amendment. In its brief before this court EAC argues that the Secretary's actions violate the fifth amendment "whether analyzed under Due Process Clause or Takings Clause cases." Brief for Appellant at 34. Because we hold that the property affected by the 1987 amendments is not "property" for purposes of either clause, we need not apply the distinct standards of review that have been developed by the Supreme Court over the years. *Compare Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717 (1984) (due process clause) *with Connolly v. Pension Benefit Guar. Corp.*, 475 U.S. 211 (1985) (takings clause).

[15]Several district courts have addressed similar constitutional challenges by other guaranty agencies throughout the nation, and have reached different results. *Compare Great Lakes Higher Educ. Corp. v. Cavazos*, 711 F. Supp. 485 (W.D. Wis. 1989) *and Connecticut Student Loan Found. v. Cavazos*, Civil No. H89-182 (D. Con. Jan. 10, 1990) (holding 1987 amendments constitutional) *with Ohio Student Loan Comm'n v. Cavazos*, 709 F. Supp. 1411 (S.D. Ohio 1988) (holding 1987 amendments unconstitutional). Two

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A.

EAC challenges two governmental actions: (1) the passage of the 1987 amendments to the Act which require EAC to transfer $6.6 million from its reserve fund to the Secretary (the transfer requirement) and (2) the withholding by the Secretary of $6.6 million in federal reimbursements after EAC refused to comply with the transfer requirement. On appeal, EAC emphasizes the withholding of reimbursements, arguing that withholding reimbursements to satisfy the transfer requirement constitutes an unconstitutional abrogation of the Secretary's contractual duty to reimburse EAC on loans guaranteed prior to December 22, 1987. We find it logical to consider first whether Congress can, consistently with the fifth amendment, require EAC to relinquish $6.6 million from its reserve fund. We will then consider whether the Secretary's method of collecting the $6.6 million in excess cash reserves, that is, by withholding reimbursements, is an unconstitutional abrogation of the Secretary's contractual obligations.

1.

EAC argues that the fifth amendment prohibits Congress from requiring EAC to relinquish $6.6 million in "excess cash reserves." Whether analyzed as a deprivation of property without due process or a taking without just compensation, we must first identify the property affected by the governmental action in order to decide whether it constitutes "property" deserving protection of the fifth amendment. *See Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1000-04 (1984) (addressing first whether Monsanto had a property interest in data submitted to the U.S. Environmental Protection

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district court decisions holding the 1987 amendments unconstitutional were reversed by the Fourth Circuit in *South Carolina State Education Assistance Authority v. Cavazos*, No. 89-2975 (4th Cir. March 7, 1990) (consolidated with Nos. 89-2976, 89-2978, 89-2982).

Agency). The property targeted by the 1987 amendments is EAC's reserve fund. After examining the composition and nature of EAC's reserve fund, we conclude that it does not constitute property deserving protection of the fifth amendment's due process or takings clause. Our opinion is consistent with the Fourth Circuit's decision in *South Carolina State Education Assistance Authority* v. *Cavazos*, No. 89-2975 (4th Cir. Mar. 7, 1990) (consolidated with Nos. 89-2976, 89-2978, 89-2982) *(South Carolina v. Cavazos)*.

The Secretary argues that EAC's excess reserves come from insurance premiums EAC has collected over the years, "a small amount of cash from other sources," and investment earnings on its total reserve fund. Brief for Appellee at 25-26. Because the excess reserves do not include administrative cost allowances or federal reimbursements which EAC has a contractual right to receive, the Secretary argues, EAC has no property interest in the excess reserves. *Id.* at 25. We are not persuaded by this argument because EAC's reserve fund is unsegregated and we cannot therefore trace the various sources of the $6.6 million targeted by the transfer requirement.[16] Instead of considering whether and to what extent EAC has a property interest in the various sources that supply its reserve fund, we consider EAC's interest in the reserve fund as a whole.

A guaranty agency's "reserve fund" is entirely a creature of federal regulation. Title 34 C.F.R. § 682.410(a)(1) (1988) requires the guaranty agency to establish and maintain a "reserve fund" and to credit to that fund payments from the federal government, collections on defaulted loans, investment earnings, and gifts or grants from other sources. Title 34 C.F.R. § 682.410(a)(2) and (a)(3) (1988) restrict the agency's use of reserve fund assets to GSL purposes such as paying default claims, refunding overpayments of insurance premiums, repaying advances made by the Secretary, and admin-

[16]Only federal advances are accounted for separately in the reserve fund. 34 C.F.R. § 682.410(a)(4)(ii)(1988).

istering the agency's guaranty program. Federal regulation authorizes the agency to invest the assets in its reserve fund in low-risk securities only. 34 C.F.R. § 682.419(a)(5) (1988) [*sic*]. In doing so, the agency must exercise the same level of care as a fiduciary "charged with the duty of investing the money *of others.*" *Id.* (Emphasis added)

Because of the extensive federal regulation of EAC's reserve fund, we hold that EAC has no ownership interest in its reserve fund that entitles EAC to protection under the fifth amendment. EAC argues that federal regulation of an individual's use of property does not automatically deprive that property of the fifth amendment's protections against government taking. We agree with EAC that to so hold would allow the government to "poach the coffers" of financial institutions, insurance companies, and non-profit corporations. Brief for Appellant at 42. Such a narrow reading of property protected by the fifth amendment is clearly not warranted. *See United States v. 564.54 Acres of Land,* 441 U.S. 506 (1979) (non-profit corporation entitled to compensation for the government's condemnation of its land for public recreation project). However, EAC's assertion that government regulation, "no matter how pervasive" cannot transform property into "public property" goes too far. Brief for Appellant at 43. Whether certain property is within the ambit of the fifth amendment depends on the unique circumstances of each case. In this case, several factors convince us that EAC has no fifth amendment property interest in the excess cash reserves. They include (1) the purpose of the guaranty agency and its reserve fund (to service the federally-created GSL program), (2) the understandings of the agencies expressed in their agreements with the Secretary, and (3) the regulations governing the composition and nature of the reserve fund.

When considering whether certain property is protected by the fifth amendment, we are mindful that property interests are not created by the Constitution, but are instead

defined by "existing rules or understandings that stem from an independent source. . . ." *Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1001 (1984) *(Ruckelshaus)* (citing *Board of Regents v. Roth*, 408 U.S. 564, 577 (1972)). That independent source may be state law, as in *Ruckelshaus*, or it may be, as in this case, federal law which defines a person's relation to a particular thing. *See Flemming v. Nestor*, 363 U.S. 603, 608-11 (1960) (considering the statutory scheme created by the Social Security Act and concluding that an employee's right to benefits under the Act is not an accrued property right protected by the fifth amendment). Here, federal law dictates the existence, content and uses of EAC's reserve fund and provides that the fund be maintained by EAC for the limited purpose of servicing the GSL program established by Congress. EAC's interest in the fund is analogous to that of a trustee holding money for the benefit of another. In this case, the beneficiary is the general public. In *Dayton-Goose Creek Ry. v. United States*, 263 U.S. 456, 484 (1924) *(Dayton-Goose Creek)*, the Supreme Court held that a rail carrier's interest in excess profits is not property under the fifth amendment because Congress declared the carrier to be only a trustee for earnings in excess of a fair rate of return. Describing the Transportation Act of 1920 under attack in *Dayton-Goose Creek*, the Supreme Court noted:

> It aims to give the owners of the railways an opportunity to earn enough to maintain their properties and equipment in such a state of efficiency that they can carry well this burden. To achieve this great purpose, it puts the railroad systems of the country more completely than ever under the fostering guardianship and control of the Commission. . . . *Dayton-Goose Creek*, 263 U.S at 478.

In addition to the statutes and regulations governing the GSL program, EAC's own agreements with the Secretary help us define its interest in the reserve fund. EAC agreed to be bound by all subsequent changes in the Act, and must

have anticipated that some of those changes would impact its reserve fund balance. Indeed such changes have occurred. In 1986, Congress demanded that agencies pay the government, from their reserve fund, an insurance premium. 1986 Amendments, 100 Stat. at 1380 (codified at 20 U.S.C. § 1078(c)(9) (1988)). In the same year, the Secretary promulgated regulations strengthening the requirement that agencies exercise due diligence in collecting loans. *See* 34 C.F.R. §§§ 682.402, 682.410, 682.411 (1988). Failure to satisfy the due diligence requirements allows the Secretary to withhold reimbursements. 34 C.F.R. §§ 682.402(h)(1)(iv) and 682.406(a)(1) (1988). In light of these circumstances, we hold that EAC has no fifth amendment property interest in its reserve fund. Consequently, Congress' mandate that EAC relinquish $6.6 million in excess cash reserves does not violate either the fifth amendment's takings or due process clause.

We turn now to whether the method the Secretary used to enforce the transfer requirement, withholding reimbursements EAC would otherwise have been eligible to receive, is an unconstitutional abrogation of EAC's contractual rights against the government. We agree with the district court that the withholding of reimbursements does not constitute a breach of EAC's contract with the Secretary. Although the 1987 amendments did modify statutory language confirming that guaranty agencies have a "contractual right" to federal reimbursements,[17] the amendments did not alter EAC's preexisting legal rights. As already noted, EAC's contractual right to reimbursement was always contingent on EAC's compliance with federal law and regulations. In its agreements with the Secretary, EAC agreed to be bound by "all

[17]As amended in 1987, 20 U.S.C. § 1078(c)(1)(A) (1988) states: "The guaranty agency shall, *subject to 20 U.S.C. § 1072(e) of this title,* be deemed to have a contractual right against the United States . . . to receive reimbursement according to the provisions of this subsection." 20 U.S.C. § 1078(c)(1)(A) (underscored language added by Pub. L. No. 99-498, 100 Stat. at 1381).

changes in the Act or regulations in accordance with their respective effective dates." EAC also gave the Secretary the right to withhold payments owing to EAC if the Secretary finds that "there has been a failure by [EAC] to comply with any of the provisions of this Agreement or applicable Federal law or regulations." We agree with the district court that this language gives the Secretary the right to withhold reimbursements until EAC is in compliance with the transfer requirement and therefore the withholding does not constitute a breach of contract.

EAC argues that the contract language does not give the Secretary the right to withhold reimbursements on loans that were guaranteed *before* the transfer requirement went into effect. Therefore, EAC argues, the withholding constitutes a breach of contract and a violation of the fifth amendment.[18] Even were we to agree with EAC, however, that the 1987 amendments alter the terms of EAC's contracts with the Secretary by allowing the Secretary to withhold reimbursements until EAC transfers its excess reserves, we do nnot find a violation of the fifth amendment.

Whether a contractual right against the United States constitutes a vested property right for fifth ammendment purposes depends on whether Congress reserved power to alter the terms of the contract. In *Bowen v. Agencies Opposed to Social Security Entrapment,* 477 U.S. 41 (1986)

[18]Clearly, a contractual right against the United States can constitute property within the meaning of the fifth amendment. In *Lynch v. United States,* 292 U.S. 571 (1933), the Supreme Court held that the plaintiffs, who had paid the government monthly premiums in return for its promise to insure plaintiffs against death or total disability arising from World War I, had a contractual right to receive benefits from the government which was protected by the fifth amendment. *Id.* at 577, 579. The Supreme Court struck down Congress' attempt to relieve the government of liability on the contracts without compensating the plaintiffs. *Id.* at 580.

(Bowen), the Supreme Court concluded that Congress' express reservation of authority to alter the provisions of the Social Security Act, combined with Congress' need to be responsive to "ever-changing conditions" affecting the social security program, rendered California's contractual right to withdraw from the social security program subject to repeal by Congress without the protections contained in the fifth amendment. *Id.* at 51-52 (quoting *Flemming v. Nestor*, 363 U.S. 603, 610 (1960)).

Unlike the facts in *Bowen*, Congress did not expressly reserve the right to amend or repeal the Act. We agree with the Fourth Circuit, however, that Congress implicitly reserved the right to amend the Act and alter the terms of EAC's agreement with the Secretary.[19] *South Carolina v. Cavazos*, slip op. at 10. Our holding is supported by the Supreme Court's pronouncement in *Bowen* that "contracts should be construed, if possible, to avoid foreclosing exercise of sovereign authority." *Bowen*, 477 U.S. at 52-53. The Supreme Court went on to note that this proposition takes on "added force when the arrangement pursuant to which the Government is claimed to have surrendered a sovereign power is one that serves to implement a comprehensive social welfare program affecting millions of individuals throughout our Nation." *Id.* at 53.[20]

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[19]The district court found such a reservation in regulations promulgated pursuant to the Act and in the language of the Secretary's contracts with FAC. *See* 34 C.F.R. § 682.400(d) (1988) (providing that agreements between guaranty agencies and the Secretary are subject to subsequent changes in the Act). We are not convinced, however, that an agency, without any direction from Congress, may reserve the right to alter the terms of its agreements with private individuals. *See Lynch v. United States*, 292 U.S. 571, 578 ("[N]o power to curtail the amount of the benefits which Congress contracted to pay was reserved to Congress; and none could be given by any regulation promulgated by the Administrator.").

[20]Dicta in the Supreme Court's opinion intimates that rather than having to find an express reservation of the right to amend, we need only find that Congress did not surrender its sovereign

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That Congress intended to reserve its authority is implicit in the purpose and structure of the GSL program and from Congress' exercise of that authority prior to the amendments in question. As the district court recognized, the GSL program is essentially a social welfare program designed to help the nation's youth gain access to higher education that they otherwise could not afford. Like the Social Security Act, the Higher Eduction *[sic]* Act needs to be responsive to "ever-changing" conditions *See id.* at 51; *Flemming v. Nestor*, 363 U.S. at 610. Prior to the amendments in question, Congress took advantage of its power to modify the terms of the Secretary's agreements with the guaranty agencies when in 1986 it amended the Act to impose a reinsurance fee on guaranty agencies to be paid from their reserve funds. 1986 Amendments, 100 Stat. at 1380. Given the Supreme Court's reluctance in *Bowen* to require an express reservation, we find that Congress never intended to relinquish its authority to impose additional requirements on guaranty agencies not contemplated in their agreements with the Secretary.

Having concluded that Congress reserved the right to modify the terms of EAC's agreement with the Secretary, we turn to whether Congress' exercise of that authority in this instance, namely conditioning EAC's right to reimbursement on compliance with the transfer requirement, exceeds the limits on Congress' power to modify government obligations.[21] Congress is not free to entice a party into a contract

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power in unmistakable terms. *Bowen v. Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 52 (1986) (citing *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 147-48 (1982)). In other words, Congress maintains the right to alter the terms of a contract entered into by the United States under Congress' authority unless it has explicitly waived that right in unmistakable terms. No such waiver can be found in the Act.

[21]The limits on Congress' ability to alter by statute the terms of a private agreement entered into with the United States were first enunciated in the *Sinking-Fund Cases*, 99 U.S. 700, 721 (1878). Although the Supreme Court upheld a statute requiring the Union

(Footnote continued on following page)

by making certain pledges and then withdraw those pledges. *See Perry v. United States,* 294 U.S. 330, 350 (1934) *(Perry).* In *Perry,* the Supreme Court noted that Congress is "free to reduce gratuities deemed excessive [b]ut . . . without power to reduce expenditures by abrogating contractual obligations of the United States." *Id.* at 352. The Supreme Court reiterated in *Bowen* that "Congress does not have the power to repudiate its own debts, which constitute 'property' to the lender, simply in order to save money." *Bowen,* 477 U.S. at 55 (citing *Perry,* 294 U.S. at 350-51).

We do not believe the language in the 1987 amendments conditioning EAC's contractual right to reimbursement on compliance with the transfer requirement repudiates a debt of the United States. Although Congress has added another condition to EAC's contractual right to reimbursement, the condition does not amount to a complete unmaking of the contract admonished by the Supreme Court in the *Sinking-Fund Cases,* 99 U.S. at 720-21 and in *Bowen,* 477 U.S. at 55. The purpose of the 1987 amendments was not to relieve the government of its obligation to reimburse guaranty agencies. Indeed EAC still has a contractual right to reimbursement. Rather, the purpose of the amendments was to recapture funds being held by the agencies that Congress deemed were not necessary to the continued functioning of the agency. 1987 USCAAN AT 2313-1264. *Cf. Bowen v. Gilliard,* 483 U.S. 587 (1987) (addressing the constitutionality of a requirement in the Deficit Reduction Act of 1984 that a family's

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(Footnote continued from previous page)
Pacific Railroad Company to set aside a portion of its income in a "sinking-fund" in order to ensure that the company would be able to pay off its debts, the Court noted, "[i]n so doing [Congress] cannot undo what has already been done, and it cannot unmake contracts that have already been made, but it may provide for what shall be done in the future, and may direct what preparation shall be made for the due performance of contracts already entered into." *Id. See also Perry v. United States,* 294 U.S 330, 350 (1934) (striking down an attempt by Congress to abrogate the gold clause in government bond obligations).

eligibility for welfare benefits take into account the income of parents and siblings living in the same house). The amendments merely add to the numerous statutory and regulatory requirements with which a guaranty agency must comply. Only the enforcement of the amendments involves the withholding of reimbursements. Congress was free to build in some method of enforcing the transfer requirement, and we hold that the withholding of reimbursements until the excess reserves are recaptured was a constitutionally permissible method of enforcement. *See United States v. Locke*, 471 U.S. 84, 107 (1984) ("Regulation of property rights does not 'take' private property when an individual's reasonable, investment-backed expectations can continue to be realized as long as he complies with reasonable regulatory restrictions the legislature has imposed.").

IV.

For the reasons stated above, we affirm the decision of the district court. We hold that the Secretary's denial of EAC's request for a waiver was not arbitrary or capricious. We also hold that the reserve fund is not property for purposes of the fifth amendment and that the Secretary did not breach its contract with EAC by withholding reimbursements in order to enforce compliance with the transfer requirement.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT

UNITED STATES DISTRICT COURT
DISTRICT OF SOUTH DAKOTA
NORTHERN DIVISION

FILED
July 14, 1989
William F. Clayton
Clerk

CLM

EDUCATION ASSISTANCE CORPORATION,

Plaintiff

vs. CIV. 88-1054

ORDER

LAURO F. CAVAZOS, Secretary of Education,

Defendant.

Pursuant to the memorandum opnion [*sic*] filed in the above captioned case on this date, it is

ORDERED that plaintiff's motion for summary judgment is denied. It is further

ORDERED that defendant's motion for summary judgment is granted.

Dated July 14, 1989.

BY THE COURT:

DONALD J. PORTER
Chief Judge

ATTEST:
WILLIAM F. CLAYTON,
CLERK

BY: CAROL L. MERRILL
Deputy

UNITED STATES DISTRICT COURT
DISTRICT OF SOUTH DAKOTA
NORTHERN DIVISION

DONALD J. PORTER
CHIEF JUDGE
413 U.S. COURTHOUSE
PIERRE, SOUTH DAKOTA 57501

July 14, 1989

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RE: CIVIL NO. 88-1054
EDUCATION ASSISTANCE CORPORATION, Plaintiff
vs.
LAURO F. CAVAZOS, Secretary of Education, Defendant

Dear Counsel:

MEMORANDUM OPINION

On December 12, 1988, plaintiff Education Assistance Corporation (EAC) filed this action to challenge whether defendant Secretary of Education pursuant to a provision of the Omnibus Budget Reconciliation Act of 1987 (Budget Act) can claim some $6.6 million from a reserve fund held by EAC. The parties have filed cross motions for summary judgment and made oral arguments before this Court. The case presents three legal issues: 1) whether it was arbitrary and capricious for the Secretary to refuse to grant EAC a waiver from the Budget Act amendments to the Higher Education Act of 1965; 2) whether the Budget Act provisions at issue and the Secretary's actions thereunder breach contracts existing between EAC and the Secretary; and 3) whether the Budget Act is an unconstitutional taking of EAC's property without just compensation.[1] This Court resolves each of these issues in the negative and thus grants judgment for the Secretary.

1. FACTS

A. The Guaranteed Student Loan Program

The Higher Education Act of 1965 established the guaranteed student loan program (GSL program) to assist students in financing their post-secondary education. Under the GSL program, private lenders extend to eligible students unsecured loans which are in effect subsidized by the federal government. The government indirectly provides insurance

[1] The Budget Act spurred a number of suits by guaranty agencies like EAC, presenting similar issues. Four such cases have been decided on their merits with the Secretary prevailing in one suit, *Great Lakes Higher Educ. Corp.* v. *Cavazos*, 711 F. Supp. 485 (W.D. Wisc. 1989) and the guaranty agency prevailing in the other three suits, *Maryland Higher Educ. Loan Corp.* v. *United States Dept of Educ.*, Civ. S 89-270, slip.op (D. Md. June 12, 1989); *South Carolina State Educ. Assistance Auth.* v. *Cavazos*, 3:88-2710-16, slip op. (D.S.C. May 31, 1989); *Ohio Student Loan Commission* v. *Cavazos*, 709 F. Supp. 1411 (S. D. Ohio 1989).

to lenders against losses on these loans through a guaranty program administered by either state agencies or non-profit private organizations known as "guaranty agencies". Guaranty agencies insure private lenders of repayment of student loans, provide information about the GSL program, recruit and oversee lenders in the program, and monitor the enrollment status of students. When there is a default on an insured guaranteed student loan, the guaranty agency—and not the federal government—is liable to the private lender. The federal government contracts with guaranty agencies to "reinsure"—*i.e.* reimburse—the guaranty agencies for all or part of the insurance payouts that they make.

The guaranty agency for the State of South Dakota is plaintiff EAC.[2] Prior to 1978, South Dakota did not have a guaranty agency. In 1978, Congress amended the Higher Education Act of 1965 to encourage more states to establish state guaranty agencies by increasing the maximum rate of federal reinsurance of guaranty agency payouts to lenders from 80% to 100% and by providing other incentives for the creation of guaranty agencies. EAC was organized as a non-profit corporation in 1978 and was designated by the Governor of South Dakota as the guaranty agency for South Dakota. EAC is a private, non-profit corporation which is not affiliated with either the state or the federal government.

On November 14, 1978, to begin its participation in the GSL program, EAC entered into four contracts with the Commissioner of Education, the predecessor of the Secretary of Education. The four contracts are the *basic contract*, the *advances contract*, the *reinsurance contract*, and the *supplemental reinsurance contract*. In relevant part, the basic contract recognizes EAC as the guaranty agency of South Dakota under the Higher Education Act and provides that lenders who receive EAC's guarantee also will receive a federal interest subsidy. The advances contract entitles

[2]EAC formerly was the South Dakota Education Assistance Corporation.

EAC to receive cash advances from the Secretary to augment a reserve fund which EAC relies upon to finance its operations and meet its obligations. By May 29, 1984, EAC had received $2,291,918.00 of federal advances pursuant to the advances contract. Under the advances contract and federal law, the Secretary may require repayment of these advances when they exceed 20% of EAC's outstanding insurance obligation. The reinsurance contract provides that EAC shall be reimbursed or "reinsured" in an amount equal to 80% of its total insurance payouts. The supplemental reinsurance contract provides that the Secretary shall reinsure EAC up to 100% of the amount paid to lenders on defaults of insured student loans. Several of these contracts contain provisions obliging EAC to comply with changes in federal law governing the GSL program.

Under these agreements and applicable federal law, reinsurance at 100% is available to EAC as long as EAC's default rate does not exceed 5% of the amount of EAC guaranteed loans that were in repayment at the end of the preceding fiscal year. EAC would receive 90% reinsurance if the default rate is between 5% and 9% and would be reinsured only for 80% of insurance payouts if the default rate exceeded 9%. 20 U.S.C. § 1078(c); 34 C.F.R. § 682.405. In addition, EAC receives administrative cost allowances from the federal government in the amount of 1% of the total new loans guaranteed. 20 U.S.C. § 1078(f).

Prior to the December 22, 1987 passage of the Budget Act, EAC had guaranteed a portfolio of loans not fully repayable until 2003. Pending full repayment of these loans, EAC has continuing obligations to make payments to lenders upon defaults of insured loans. To finance its operations and to meet its insurance obligations, EAC maintains a "reserve fund."

EAC's reserve fund consists of insurance fees it has charged lenders,[3] various federal advances, federal reinsurance payments, administrative costs allowances, state appropriations, monies regained in post-default collections,[4] and investment earnings on the fund. Federal law restricts use of the reserve fund to GSL program purposes. 34 C.F.R. §§ 682.410(a)(2)-(4). Although the primary expenses incurred by EAC—insurance payouts and administrative costs—are defrayed by the Secretary through reinsurance and administrative cost allowances, the federal payments do not reimburse EAC for all such costs, and the potential for less than a 100% reinsurance rate makes a reserve fund necessary. The reserve fund is the primary asset of guaranty agencies like EAC.

EAC's sister company is South Dakota Student Loan Corporation (SDSLC), which also is a non-profit organization established in 1978. SDSLC operates a secondary market for guaranteed student loans by purchasing student loans from lenders. By establishing an active secondary market for these loans, SDSLC makes student loans a more attractive investment for lenders. To facilitate the operation of a secondary market, SDSLC has entered into guarantee reserve agreements with EAC. Under these guarantee reserve agreements, EAC has pledged to keep the reserve fund at not less than 2% of the unpaid principal amount of all loans EAC has guaranteed or at such lower amount as a trustee deems reasonable.[5] The guarantee reserve agreements also

[3]Under 20 U.S.C. § 1078(b)(i)(H), EAC can charge up to 3% of the loan amount as an insurance fee. This fee commonly is passed directly on to borrowers. Recently, EAC has not been charging an insurance fee in an effort to entice lenders to use EAC as their guaranty agency.

[4]EAC can keep 30% of whatever defaulted loan amount it collects, but pays for the costs of seeking recovery on defaulted loans. 20 U.S.C. § 1078(c)(6).

[5]For the complete text of this provision, see *infra* footnote 9.

commit EAC to using the reserve fund only for GSL program purposes.

The GSL program in South Dakota has flourished since 1978. As of September of 1988, EAC had guaranteed over $421 million of student loans obtained by some 90,000 individual borrowers. EAC also has built a reserve fund which was consistently over $10 million from 1986 to 1988. A large reserve fund, however, may be typical for relatively new guaranty agencies like EAC; as more loans become due, more defaults occur, and more money must be paid out of the reserve fund to meet insurance obligations.[6]

B. The Budget Act and Resulting Dispute.

On December 22, 1987, Congress passed the Budget Act to finance governmental operations in 1988. Among the many provisions of the Budget Act were amendments to the Higher Education Act of 1965 (Budget Act amendments). These amendments were designed to recover "excess cash reserves" accumulated by guaranty agencies under the GSL program.

The Budget Act amendments are based on a July 1986 report from the Comptroller General and an August 1986 General Accounting Office report. These studies concluded that guaranty agencies had amassed unnecessarily large re-

[6]Under the reinsurance and supplemental reinsurance agreements, the federal government is obliged to reinsure EAC for up to 100% of these losses. If the default rate rises to between 5% and 9%, EAC receives only 90% reinsurance. Reinsurance can drop as low as 80% if the default rate exceeds 9%, leaving EAC to absorb the remaining loss and thus reducing the reserve fund. 20 U.S.C. §1078(c).

According to a recent newspaper article, the default rate on guaranteed student loans for students who attend a four year college averages roughly 9%. The average default rate for students who attend trade schools is substantially higher. The Christian Science Monitor, June 16, 1989, at 20.

serve funds and that the federal government could reclaim a portion of these funds. While struggling to bring the federal budget into compliance with the guidelines in the Gramm-Rudman-Hollings Act, Congress decided to obtain $250 million from excess cash reserves held by guaranty agencies to help finance federal expenditures under the GSL program.

Largely adopting the recommendations of the General Accounting Office, the Budget Act amendments require the Secretary of Education to make a determination of each guaranty agency's excess cash reserves under a specified formula.[7] The provisions then require the Secretary to recover the excess reserves by requiring repayment of any advances, withholding or cancelling claims for reimbursement otherwise payable, reducing the amount of administrative cost allowance payments, or reducing payments from or increasing payments required to the federal government by any other method. 20 U.S.C. § 1072(e)(2). The amounts obtained from guaranty agencies under the Budget Act are deposited in the student loan insurance fund held by the Department of Education for satisfaction of the government's obligations under the GSL program. 20 U.S.C. § 1081(a). In addition, the Budget Act amends 20 U.S.C. § 1078(c)(1)(A) to make a guaranty agency's contractual rights to reinsurance subject to compliance with the payment of the excess cash reserves. The provisions authorize

[7]Under 20 U.S.C. § 1072(e)(1), excess cash reserves of a guarantee agency are those which exceed the greater of: 1) 40% of the amount it paid on insurance claims during the preceding fiscal year; 2) 0.3% of the original principal amount of its insured loans outstanding at the end of such preceding year; 3) an amount which, when combined with the amounts owed by the Secretary to the guarantee agency for reinsurance claims and administrative cost allowances, less the amounts payable by the guarantee agency to the Secretary for collections and reinsurance fees, at the end of such fiscal year equals 0.4% of each original principal amount; 4) $500,000; or 5) the amount required to comply with the reserve requirements of the state law in effect on October 17, 1986.

the Secretary to seize in aggregate $250 million from guaranty agency reserve funds. *See* 20 U.S.C. § 1072(e)(4).

EAC responded to the Budget Act by notifying the Secretary of Education that it did not consent to any changes in the existing contracts, considered the Budget Act amendments to be an abrogation of the contracts, and would not guarantee any new student loans under the contracts with the Secretary. Indeed, since December 21, 1987, EAC has guaranteed student loans only through a Pennsylvania agency. EAC was the lone guaranty agency in the United States to terminate its relationship with the Secretary due to the Budget Act. In a letter dated January 25, 1988, the Secretary notified EAC that he viewed the actions of EAC as a termination of the existing agreements. The Secretary therefore decided that EAC was ineligible to receive reinsurance on any loans guaranteed on or after December 22, 1987. The termination of the contract, however, does not affect reinsurance of loans guaranteed before December 22, 1987 or any obligation EAC might have to remit part of the reserve fund under the Budget Act.

On February 16, 1988, the Secretary notified EAC that $6,607,592.00 was the excess amount in EAC's reserve fund pursuant to the Budget Act amendments and directed EAC to select a method of paying this amount. Not surprisingly, EAC objected.

EAC then commissioned the national accounting firm of Touche Ross & Co. to evaluate the impact on EAC of a $6.6 million reduction in EAC's reserve fund. Based on the Touche Ross study, the EAC on March 15, 1988 requested the Secretary to grant a waiver from the Budget Act amendments under 20 U.S.C. § 1072(e)(3). In a letter dated September 26, 1988, the Secretary denied EAC's request. The Secretary again instructed EAC either to choose a method for surrender of its excess cash reserves or to expect the Secretary to withhold pending or future reinsurance until $6.6 million is retained. EAC refused to transfer the money to the

Secretary, and the Secretary subsequently has refused to reinsure EAC on claims made for defaulted loans until the Secretary obtains $6.6 million. By February 22, 1989, the Secretary had withheld over $2.4 million of reinsurance benefits. EAC now has pending an additional request for $394,919.56 of reinsurance claims, which the Secretary is refusing to pay.

II. LEGAL ISSUES

The cross-motions for summary judgment raise three legal issues: 1) whether it is arbitrary and capricious for the Secretary to deny EAC a waiver under 20 U.S.C. § 1072(e)(3); 2) whether the Budget Act and actions taken by the Secretary thereunder are breaches of contracts with EAC; and 3) whether the Budget Act is an unconstitutional taking of EAC's property in violation of the fifth amendment. There are no material facts at issue. This Court first will examine the issue of whether the Secretary erred in denying EAC a waiver, since resolution of this issue may obviate the need to rule on EAC's constitutional claim. *See Jean v. Nelson*, 472 U.S. 846, 854 (1985).

A. Refusal to Grant EAC a Waiver

Under 20 U.S.C. § 1072(e)(3), the Secretary may grant a guaranty agency a waiver from the Budget Act amendments. EAC submitted documents and made oral arguments to the Secretary for a waiver under § 1072(e)(3). Basing his decision solely on EAC's submissions, the Secretary denied EAC a waiver.

Both parties agree that the administrative law standard for review of the Secretary's decision is the arbitrary and capricious standard. An administrative action is arbitrary and capricious only when there is no rational basis for the action. *Moore v. Custis*, 736 F.2d 1260, 1262 (8th Cir. 1984). In addition, deference usually is accorded an administrative agency's interpretation of a statute it is charged to apply,

though federal courts retain the ultimate authority to determine the meaning and proper application of federal statutes. *See generally Udall v. Tallman*, 380 U.S. 1, 16 (1965). In the instant case, the challenged administrative action is the Secretary's determination that EAC does not satisfy the waiver provisions of § 1072(e)(3).

EAC argues that it qualifies for a waiver under two different subdivisions of 20 U.S.C. § 1072(e)(3). First, EAC asserts that it has experienced "significant changes in the economic circumstances of the loan insurance program [that] render the amount of the agency's determined maximum cash reserves inadequate for the continued functioning of the agency." 20 U.S.C. § 1072(e)(3)(ii). To substantiate this claim, EAC relies upon a report it commissioned from Touche Ross & Co., which concludes that payment of $6.6 million from the EAC guarantee fund would endanger the continued existence of EAC.

The Secretary decided that EAC had not shown a significant change in the economic circumstances which render the cash reserves inadequate. The Secretary did not probe the accuracy of the Touche Ross study, but regarded the study as a speculative forecast that was insufficient to warrant a waiver under § 1072(e)(3)(ii). Instead, the Secretary focused heavily on the immediate effect of the Budget Act amendments on the reserve fund held by EAC and noted that the amount of excess cash reserves claimed from EAC did not deviate from the amount authorized by the statutory formula codified at § 1072(e)(1). Although the Secretary perhaps took an overly narrow view of the waiver available under § 1072(e)(3)(ii), the ultimate decision that EAC had not experienced sufficient "changed economic circumstances" is not arbitrary and capricious in light of the congressional intent of the Budget Act.

The obvious intention of the Budget Act amendments was to obtain $250 million from guaranty agency reserve funds without destroying the financial viability of the GSL program or guaranty agencies. Congress believed that the re-

serve funds had become inordinately large and could be used to fund federal expenditures in the GSL program. The waiver provisions were enacted to preserve guaranty agencies from financial ruin[8] and from being compelled to breach contracts with third parties. The Budget Act amendments in general are short-sighted and indeed are to expire on September 30, 1989. Congress' concern about changed economic circumstances under § 1072(a)(3)(ii) *[sic]* similarly seems to be a relatively short-sighted one.

Interpreting § 1072(e)(3)(ii) to permit EAC to obtain a waiver would largely undermine the purpose of the challenged Budget Act provisions. Nearly every guaranty agency faced with a reduction in its reserve fund could argue that its future viability is endangered. Congress, however, did not intend the waiver provision carved out by § 1072(e)(3)(ii) to require the Secretary to evaluate and reformulate for each individual guaranty agency the amount of "excess cash reserves" claimed. Rather, Congress explicitly set the formula to determine the amount of excess cash reserves and enacted § 1072(e)(3)(ii) to provide an exception for the rare circumstance when the reduction in the reserve fund would largely bankrupt a guaranty agency. This Court understands EAC's concern about its future business viability with a reduced reserve fund, but must apply the Budget Act provisions in a manner consistent with the intent of Congress. Although the projections contained in the Touche Ross study are largely uncontroverted and do suggest that EAC will encounter difficulty in meeting its obligations as

[8]Unfortunately, there is no federal statute obliging the Secretary to keep guaranty agencies solvent. Potentially, the diminution of reserve funds could undermine the success of the GSL program since financial trouble for guaranty agencies would make student loans a much less attractive investment for private lenders. The role of this Court, however, is not to pass judgment on the wisdom of enactments, but to evaluate their constitutionality and applicability.

the present portfolio of insured student loans matures, the immediate financial condition of EAC is stable, and thus EAC is not entitled to a waiver under § 1072(e)(3)(ii).

EAC also requested and was denied a waiver under § 1072(e)(3)(iii), which permits a waiver from the Budget Act if the "guaranty agency would be compelled to violate contractual obligations existing on [December 22, 1987] that require a specified level of reserve funds to be maintained by such agency." EAC contends that its agreements with SDSLC oblige EAC to keep the reserve fund at a level reflecting at least 2% of the total amount of loans guaranteed. EAC points to provision 5(i) of the June 1, 1987 guarantee reserve agreement, which states that EAC shall maintain in the reserve fund a minimum amount *either* 2% of the unpaid principal amount of all loans insured by EAC *or* such lesser amount as the trustee after examining financial reports deems reasonable and appropriate.[9] In denying EAC a

[9]Provision 5(i) of the guaranty reserve agreement states:

> The Guarantee Fund [*i.e.* reserve fund]:
>
> (i) shall be maintained at a minimum amount (hereinafter called the "Required Amount") as of any date of calculation equal to (A) two percent (2%) of the unpaid principal amount of all student loans insured or guaranteed by EAC, or (B) such lesser amount agreed to by the Trustee in writing, after the Trustee has examined the report of a firm of independent certified public accountants reasonably acceptable to the Trustee stating that, based on reasonable and appropriate assumptions, EAC will have sufficient cash available to carry out its guarantee function for so long as any bonds remain Outstanding and Financed Student Loans are Guaranteed by EAC, and that the Guarantee Fund will be sufficiently funded at such Required Minimum Amount to cover the reasonably expected obligations of EAC on defaulted student loans guaranteed or insured by it. If and for so long as the Required Minimum Amount is less than the amount described in clause (A), the Trustee shall receive a report as described in Clause (B) every three (3) years, and based upon a review of such report and EAC's most recent annual report of audit required pursuant to Section 7 hereof, may revise the Required Minimum Amount.

waiver under § 1072(e)(3)(iii), the Secretary determined that provision 5(i) did not require the maintenance of 2% of the unpaid balance of insured loans in the reserve fund because the trustee could authorize a lesser amount and because provision 5(ii) merely requires that EAC "take all steps necessary" and "practicable under the circumstances" to restore the reserve fund to 2% of the amount of insured loans outstanding or whatever amount the trustee approves when the reserve fund falls below the required minimum.[10]

EAC would not be "compelled to violate contractual obligations" with SDSLC by surrendering $6.6 million of the reserve fund in compliance with the Budget Act amendments. The guaranty reserve agreement can reasonably be interpreted to permit EAC to have a reserve fund under 2% of the total loans insured as long as all the monies of the reserve fund are used for GSL program purposes. EAC's payment of $6.6 million under the Budget Act would be for GSL program purposes since the monies are placed in the

[10]The guarantee reserve agreement provision 5(ii) provides:

> The Guarantee Fund [*i.e.* reserve fund]:
>
> (ii) may be used by EAC solely and only for the purpose of, at any time, permitting it to fulfill its obligations (including the repayment of any advances from the federal government) upon its guarantee or insurance of student loans, including Financed Student Loans, and, if such use reduces the amount then on deposit in the Guarantee Fund to less than the applicable Required Minimum Amount, EAC shall promptly take all steps necessary to restore the amount then on deposit in the Guarantee Fund to not less than the Required Minimum Amount as rapidly as is practicable under the circumstances then in existence. Such steps shall include, but not be limited to, continuation or imposition (beginning with the next academic year) of premiums on the guarantee or insurance of student loans at a reasonable rate, which will be sufficient to cure, at the earliest practicable date, any deficiency not covered by the application of other moneys available to EAC, and the retention of all earnings on the income from the investment of amounts on deposit in the Guarantee Fund.

student loan insurance fund under 20 U.S.C. § 1081(a) for use in funding the GSL program. Since the guarantee reserve agreements do not truly compel EAC to maintain a specified amount in its reserve fund, the Secretary did not act arbitrarily or capriciously in refusing to grant EAC a waiver under § 1072(e)(3)(iii).

B. Breach of Contract and Takings Claim

Whether there is a breach of contract in this case largely turns on the effect of reservation clauses both in agreements EAC made with the Secretary and in regulations promulgated by the Secretary. Similarly, the extent to which EAC has a fifth amendment property right to the reserve fund as a consequence of the contracts depends on the interpretation of the reservation clauses. Understandably, courts in similar cases largely have blended the analysis of breach of contract and fifth amendment taking. *South Carolina State Educ. Assistance Auth. v. Cavazos*, 3:88-2710-16, slip op. (D.S.C. May 31, 1989); *Great Lakes Higher Educ. Corp. v. Cavazos*, 711 F. Supp. 485 (W.D. Wisc. 1989); *Ohio Student Loan Comm'n. v. Cavazos*, 798 F. Supp. 1411 (S.D. Ohio 1989); *see also Orrego v. U.S. Dept. of Housing & Urban Dev.*, 701 F. Supp. 1384, 1395-97 (N.D. Ill. 1988) (analyzing contract rights and takings issues in tandem). Nonetheless, to a certain extent, these two causes of action can be analyzed separately.

1. Breach of Contract

The United States is bound by contractual obligations just as any private party, and principles of general contract law are equally applicable to government contracts unless Congress enacts special standards governing the contract. *Priebe & Sons v. United States*, 332 U.S. 407, 411 (1947); *Sinking Fund Cases*, 99 U.S. (9 Otto) 700, 715 (1879). As a general rule, the United States cannot abrogate contracts without being liable for breach of contract. *See Lynch v. United States*, 292 U.S. 571, 580 (1934); *see also Federal Housing Administration v. Darlington, Inc.*, 358 U.S. 84, 93 (1958) (Frankfurter, J., dissenting).

The United States Supreme Court, in *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986), recently examined the nature of contract obligations of the United States. In *Social Security Entrapment*, the Court evaluated whether a 1983 amendment to 42 U.S.C. § 418(a) could revoke a contract right held by states to terminate contracts with the federal government providing social security coverage of state employees. These contracts, known as "§ 418 agreements", permitted a state to terminate the agreement after giving the United States two years notice in advance of termination. *Id.* at 45. Concerned about the trend toward withdrawal of state employees from the social security system, Congress amended 42 U.S.C. § 418 in 1983 to forbid further termination of § 418 agreements even if termination notice had been given prior to 1983. *Id.* at 47-48. California was among the states that had given notice of intent to terminate several § 418 agreements, and the *Social Security Entrapment* lawsuit then was instituted to challenge the constitutionality of the 1983 amendment. *Id.* at 49.

The District Court for the Eastern District of California held the 1983 amendments to § 418 to be unconstitutional. *Public Agencies Opposed to Social Security Entrapment v. Heckler*, 613 F. Supp. 558 (E.D. Cal. 1985), *reversed*, 477 U.S. 41 (1986). The district court reasoned that the § 418 agreements between California and the federal government created a right to terminate the contract and that amendment of § 418 to eliminate this right constituted a taking of property without just compensation under the fifth amendment.

The Supreme Court reversed the district court and held that the 1983 amendment did not violate the fifth amendment. *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986). The Court noted that Congress had expressly retained the "right to alter, amend, or repeal any provision" of the governing statute. 42 U.S.C.

§ 1304. The Court interpreted the § 418 agreements with the state to incorporate impliedly this reservation of power. The Court then determined that the amendment was within those powers explicitly reserved and that the contract provision permitting states to terminate the contract did not constitute a fifth amendment property right.

In discussing the extent to which government contracts may limit congressional powers, the Court stated:

> While the Federal Government, as a sovereign, has the power to enter contracts that confer vested rights, and the concomitant duty to honor those rights, . . . we have declined in the context of commercial contracts to find that a "sovereign forever waives the right to exercise one of its sovereign powers unless it expressly reserves the right to exercise that power in the contract." *Merrion v. Jicarilla Apache Tribe*, 455 U.S. 130, 148 (1982). Rather, we have emphasized that "[w]ithout regard to its source, sovereign power, even when unexercised, is an enduring presence that governs all contracts subject to the sovereign's jurisdiction, and will remain intact unless surrendered in unmistakable terms." *Ibid.* Therefore, contractual arrangements, including those to which a sovereign itself is a party, "remain subject to subsequent legislation" by the sovereign. *Id.* at 147.

Bowen v. Agencies Opposed to Social Security Entrapment, 477 U.S. 41, 52 (1986). The Court observed that Congress had reserved the power to amend the Social Security Act and then relied on the *Sinking Fund Cases*, 99 U.S. (9 Otto) 700 (1879), to determine the effects of such a reservation in the context of government contracts.

The *Sinking Fund Cases* examined a statutory reservation of the right to repeal, alter, or amend a set of statutes which provided financing and lands to railroads in exchange for the railroads' promise to pay a certain amount to the government in the future. Before the obligation was due, Congress became concerned that the railroads would be unable to make the repayment since a large portion of their

profits had been disbursed as dividends. Consequently, Congress amended the governing statutes to require the railroads to purchase subsidy bonds and to deposit part of their earnings in a sinking fund whose trustee was the United States Treasury. The railroads challenged this scheme by arguing that the amendments to the statutes deprived them of their vested rights and due process. The Supreme Court rejected these arguments and interpreted the statutory reservation of congressional power as retaining the power to amend the statute and providing notice to the railroads of the possibility of amendment. *Sinking Fund Cases*, 99 U.S. (9 Otto) 700, 720 (1879). As the Court in *Social Security Entrapment* noted, the effect of this construction of the statutory reservation in the *Sinking Fund Cases* was to permit Congress to modify the terms of the agreement. *Bowen v. Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 53-54 (1986). Nevertheless, the Court in dicta in the *Sinking Fund Cases* stressed that as a general rule, Congress cannot freely abrogate contracts. *Sinking Fund Cases*, 99 U.S. (9 Otto) 700, 719-21 (1879). It was the reservation clause in the statutes involved in the *Sinking Fund Cases* that saved the statutory amendment from being an abrogation of contract.

The Reinsurance Agreement dated November 14, 1978 and signed by both EAC and the Secretary states that EAC "shall be bound by all changes in the Act or Regulations in accordance with their effective dates." In addition, 34 C.F.R. § 682.400(d) states that all agreements between guaranty agencies and the Secretary are subject to subsequent changes in the Higher Education Act and regulations thereunder. The Higher Education Act itself does not contain an explicit statutory reservation of a right to amend the governing statute as there was in *Sinking Funds Cases* and *Social Security Entrapment.* However, the contract provision and regulations, along with the nature of the Higher Education Act, are sufficient to preserve a right to amend under the circumstances. See *Miller* v. *New York*, 82 U.S.

(15 Wall.) 478, 496-97 (1872); *see also Stockholders of Peoples Banking Co. v. Sterling*, 300 U.S. 175, 183 (1937); *Pennsylvania College Cases*, 80 U.S. (13 Wall.) 190, 213 (1871). The contract provision and regulations provide sufficiently clear notice to EAC of the possibility of legislated changes in the contractual arrangements. In addition, although neither a contract made by EAC with the Secretary nor regulations promulgated by the Secretary can endow Congress with greater power than it already possesses, Congress in no way relinquished the power to modify the Higher Education Act and agreements executed thereunder. Indeed, Congress previously modified the Act by imposing heightened due diligence standards upon guaranty agencies in 1987 and by requiring in 1986 that guaranty agencies pay an increased reinsurance fee. Moreover, the very nature of the GSL program—a federal subsidy program to finance college educations involving not-for-profit agencies—suggests that the statutes and contracts were not immune from alteration.[11]

Undoubtedly, there are limitations on the power of Congress to alter contracts and governing statutes even when there are clauses reserving the power to amend. For instance, Congress could not entice a party into a contract with certain pledges and then withdraw those pledges. Such a "bait and switch" in the context of a federal contract probably would constitute a failure of consideration, a breach of contract, and a violation of the fifth amendment takings and due process clauses. However, there is no such "bait and

[11] As the Court stated in *Bowen v. Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 52-53 (1986):

> . . . contracts should be construed, if possible, to avoid foreclosing exercise of sovereign authority. [This is especially true] when the arrangement pursuant to which the Government is claimed to have surrendered a sovereign power is one that serves to implement a comprehensive social welfare program affecting millions of individuals throughout our Nation.

switch" in the instant case. EAC was on notice that the GSL program was subject to change. In addition, the Budget Act did not materially change the terms of the original contracts, as EAC would have remained a recognized guaranty agency entitled to receive, among other things, receive [*sic*] up to 100% reinsurance had it remitted the amount deemed to be excess reserves rather than treating the contracts as terminated. Consequently, the Budget Act amendments do not constitute a breach of contract.

Believing that the Budget Act amendments were an abrogation of the contracts, EAC halted performance under the outstanding agreements on December 22, 1987. The Secretary treated EAC's actions as a repudiation of the contracts. Having reviewed the four agreements establishing the contractual relationship between the parties, this Court finds that the Secretary's handling of the suspension of performance by EAC was not a breach of contract.

In addition, the Secretary's withholding of reinsurance until $6.6 million is obtained does not constitute a breach of contract. The right of EAC to receive reinsurance is conditioned on complying with requirements of the GSL program, such as the due diligence standards. 20 U.S.C. §§ 1078(c)(1)(A) and 1078(c)(2)(G). Since the Budget Act amendments were within the prerogative of Congress to modify the GSL program, it is not a breach of contract for Congress to further condition the right to receive reinsurance upon compliance with the Budget Act amendments.

2. Fifth Amendment Taking

The only fifth amendment takings issue in this case is whether EAC had a constitutionally protected property interest in the portion of the reserve fund deemed to be excess cash reserves under the Budget Act amendments. The parties presented arguments on whether there was a "taking", but it is clear that if the portion of the reserve fund claimed

under the Budget Act was constitutionally protected property, there was a taking. *Cf., United States v. Security Industrial Bank,* 459 U.S. 70, 75-76 (1982).

The fifth amendment protects only "property interests" from being taken without just compensation. Rights and monies obtained under government contracts may constitute protected property interests. *Lynch v. United States,* 292 U.S. 571, 579 (1934). And non-profit corporations like EAC certainly are capable of possessing property protected by the fifth amendment. *United States v. 546.54 Acres of Land,* 441 U.S. 506 (1979). A fifth amendment property interest exists when there is a right of "free use, enjoyment and disposal", *Buchanan v. Wurley* [*sic*], 245 U.S. 60, 74 (1917), or the "right to exclude others," *Ruckelshaus v. Monsanto Co.,* 467 U.S. 986, 1011 (1984).

In light of the effect of the reservation clause, the contractual arrangements between EAC and the Secretary do not create the type of "vested rights" protected by the fifth amendment. Again the most pertinent authority is *Bowen v. Public Agencies Opposed to Social Security Entrapment,* 477 U.S. 41, 55-56 (1986). In *Social Security Entrapment,* the Court determined that there was no property right under the fifth amendment in the contract clause permitting states to terminate the § 418 agreements because Congress had reserved the power to amend the statute and thus could revoke the termination clause. Similarly, the right of Congress to alter the GSL program prevents EAC from possessing a property right within the meaning of the fifth amendment to the portion of the reserve fund claimed by the Budget Act.[12] Because EAC does not have a fifth amendment property right to the part of the reserve fund claimed, there is no unconstitutional taking in this case.

[12] This conclusion is confirmed by the fact that neither the state nor private investors have contributed anything to EAC's reserve fund. Nonetheless, the federal government has relinquished all

(Footnote continued on next page)

III. CONCLUSION

The Budget Act amendments may have been hasty and ill-advised and certainly harshly affect guaranty agencies. Nonetheless, it is not the role of this Court to question the wisdom of Congress. Rather, this Court must probe possible constitutional deficiencies and apply valid statutes as Congress intended. EAC does not qualify for a waiver from the Budget Act under either § 1072(e)(3)(ii) or § 1072(e)(3)(iii). Because the regulations and agreements between EAC and the Secretary sufficiently reserve the right to modify and portend modification of the GSL program, the Budget Act amendments and the Secretary's actions thereunder are not breaches of contract. Consequently, EAC cannot claim a fifth amendment property interest in the portion of the reserve fund claimed under the Budget Act amendments. This Court therefore denies EAC's motion for summary judgment and grants summary judgment to the Secretary.

BY THE COURT:

/s/ Donald J. Porter
Chief Judge

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rights to a portion of the monies in the reserve fund held by EAC. Even the Secretary concedes that monies EAC already has obtained under the contract for administrative cost allowances and reinsurance could not be reclaimed. The Secretary, however, argues that insurance fees, investment earnings, and collections on defaults are the funds targeted by the Budget Act amendments. Though it is difficult to distinguish between various forms of money in an unsegregated reserve fund, this Court agrees with the Secretary. The social welfare underpinnings of the program, the pervasive federal involvement, and the reservations of federal power to alter the agreements convince this Court that there is no property right under the fifth amendment in the portion of the reserve fund claimed by the Budget Act amendments. *Cf., Dayton-Goose Creek Ry. Co. v. United States*, 263 U.S. 456 (1924).

FIFTH AMENDMENT TO THE UNITED STATES CONSTITUTION:

No person shall . . . be deprived of life, liberty, or property without due process of law; nor shall private property be taken for public use, without just compensation.

20 U.S.C. § 1071(a)(1):

(1) Purpose. The purpose of this part is to enable the Secretary—(A) to encourage States and nonprofit private institutions and organizations to establish adequate loan insurance programs for students in eligible institutions (as defined in section 1085 of this title), (B) to provide a Federal program of student loan insurance for students or lenders who do not have reasonable access to a State or private nonprofit program of student loan insurance covered by an agreement under section 1078(b) of this title, (C) to pay a portion of the interest on loans to qualified students which are insured under this part, and (D) to guarantee a portion of each loan insured under a program of a State or of a nonprofit private institution or organization which meets the requirements of section 1078(a)(1)(B) of this title.

20 U.S.C. § 1078(c)(1)(A):

(c) GUARANTY AGREEMENTS FOR REIMBURSING LOSSES.—

(1) AUTHORITY TO ENTER INTO AGREEMENTS.—(A) The Secretary may enter into a guaranty agreement with any guaranty agency, whereby the Secretary shall undertake to reimburse it, under such terms and conditions as the Secretary may establish, with respect to losses (resulting from the default of the student borrower) on the unpaid balance of the principal and accrued interest of any insured loan, including the administrative costs of supplemental preclaim assistance for default prevention as defined in paragraph (6)(C). The guaranty agency shall be deemed to have a contractual right against the United States, during the life

of such loan, to receive reimbursement according to the provisions of this subsection. Upon receipt of an accurate and complete request by a guaranty agency for reimbursement with respect to such losses, the Secretary shall pay promptly and without administrative delay. Except as provided in subparagraph (B) of this paragraph and in paragraph (7), the amount to be paid a guaranty agency as reimbursement under this subsection shall be equal to 100 percent of the amount expended by it in discharge of its insurance obligation incurred under its loan insurance program. In no case shall a guaranty agency file a claim under this subsection for reimbursement with respect to losses prior to 270 days after the loan becomes delinquent with respect to any installment thereon.

Pub. L. No. 100-203, §§ 3001-3002, 101 Stat. 1330, 1330-36 to 1330-38:

Subtitle A—GUARANTEED STUDENT LOAN PROGRAM SAVINGS

Sec. 3001. RECOVERY OF EXCESS CASH RESERVES ACCUMULATED UNDER THE GUARANTEED STUDENT LOAN PROGRAM.

(A) IN GENERAL.—Section 422 of the Higher Education Act of 1965 (20 U.S.C. 1072) is amended by adding at the end thereof the following new subsection:

"(e) REDUCTION OF EXCESS CASH RESERVES.—

"(1) LIMITATION OF MAXIMUM CASH RESERVES.–A guaranty agency shall not accumulate cash reserves in excess of the greater of—

"(A) 40 percent of the total amount paid by that agency on insurance claims during the preceding fiscal year;

"(B) 0.3 percent of original principal amount of loans that are insured by that agency and that are outstanding at the end of such preceding fiscal year;

"(C) an amount which, when combined with all other parts of total agency reserves, equals 0.4 percent of such original principal amount;

"(D) $500,000; or

"(E) the amount required to comply with the reserve requirements of a State law as in effect on October 17, 1986.

"(2) RECOVERY OF EXCESS CASH RESERVES.—The Secretary shall, not later than March 31, 1988, determine for each guaranty agency the maximum cash reserve permitted under paragraph (1) for fiscal year 1986. Subject to paragraphs (3) and (4), if the Secretary determines that any guaranty agency had, at the end of fiscal year 1986, a cash reserve that exceeded such maximum, the Secretary shall direct the agency to eliminate such excess by any one or more of the following methods, as selected by the guaranty agency:

"(A) by repaying any advances to such agency made by the Secretary under this section that are not required to be repaid under subsection (d);

"(B) by withholding and canceling claims for reimbursement otherwise payable under section 428(c)(1);

"(C) by reducing the amount of payments for which application will be made by such agency under section 428(f); or

"(D) by any other method of reducing payments from or increasing payments to the Federal Government, including payment of additional reinsurance fees in addition to the fees required by section 428(c)(9), as proposed by the agency and agreed to by the Secretary.

"(3) APPEALS BASED ON SPECIAL CIRCUMSTANCES.—(A) If the Secretary determines, on the basis of an application from a guaranty agency, that—

"(i) the agency's financial position has deteriorated significantly since the end of the preceding fiscal year;

"(ii) significant changes in the economic circumstances (such as a change in agency current cash reserves) or the loan insurance program render the limitations of paragraph (1) inadequate for the continued functioning of the agency; or

"(iii) in recovering funds as required by this subsection, a guaranty agency would be compelled to violate contractual obligations existing on the date of enactment of this subsection that require a specified level of reserve funds to be maintained by such agency;

the Secretary may waive, in whole or in part, the imposition of the remedies required by paragraph (2) for such agency.

"(B) The Secretary shall respond to request for waivers from guaranty agencies in an expedited manner and, except for unusual circumstances or with the consent of the guaranty agency, shall resolve such request within 6 weeks of submission.

"(4) RECOVERY LIMITS.—The Secretary shall not require a total reduction of cash reserves for all guaranty agencies in excess of $250,000,000 during fiscal year 1988. If the total of cash reserves of all guaranty agencies exceeds the maximum amounts permitted under paragraph (1) by more than $250,000,000, the Secretary shall ratably reduce the amounts that guaranty agencies are directed to eliminate under paragraph (2), so that the total excess cash reserves to be eliminated equals $250,000,000.

"(5) DEFINITIONS.—As used in this subsection—

"(A) the 'cash reserves' for any guaranty agency for any fiscal year are equal to the agency's cumulative cash receipts less the agency's cumulative cash disbursements at the end of such fiscal year;

"(B) the 'total reserves' for any guaranty agency for any fiscal year are equal to the agency's cash reserves plus the agency's cumulative accounts receivable less the agency's accounts payable, as of the end of such fiscal year;

"(C) the term 'cumulative cash receipts' includes such receipts as insurance premiums, Federal reinsurance payments, and collections on defaulted loans;

"(D) the term 'cumulative cash disbursements' includes such disbursements as payments for default claims, repayment of Federal advances, transfers to other State activities, and payment of collection costs and other operating costs;

"(E) the term 'accounts receivable' includes Federal reinsurance payments and administrative cost allowances owed but not yet paid to the guaranty agency, as of the end of a fiscal year; and

"(F) the term 'accounts payable' includes collections and reinsurance fees due (but not paid) to the Department of Education, as of the end of a fiscal year".

(b) CONFORMING AMENDMENTS.—

(1) The second sentence of section 428(c)(1)(A) of such Act (20 U.S.C. 1078(c)(1)(A)) is amended by striking out "shall be deemed" and inserting "shall, subject to section 422(e), be deemed".

(2) Section 428(c)(9)(A) of such Act is amended by striking out "an amount equal to" and inserting "an amount, subject to section 422(e), equal to".

(3) The second sentence of section 428(f)(1)(B) of such Act is amended by striking out "shall be deemed" and inserting "shall, subject to section 422(e), be deemed".

SEC. 3003, REPEAL.

(a) IN GENERAL.—Subsection (e) of section 422 of the Higher Education Act of 1965 (20 U.S.C. 1072) is repealed on September 30, 1989.

(b) CONFORMING AMENDMENTS.—

(1) Effective September 30, 1989, the second sentence of section 428(c)(1)(A) of such Act (20 U.S.C. 1078(c)(1)(A)) is

amended by striking out "shall, subject to section 422(e), be deemed" and inserting "shall be deemed".

(2) Effective September 30, 1989, section 428(c)(9)(A) of such Act is amended by striking out "an amount, subject to section 422(e), equal to" and inserting "an amount equal to".

(3) Effective September 30, 1989, the second sentence of section 428(f)(1)(B) of such Act is amended by striking out "shall, subject to section 422(e), be deemed" and inserting "shall be deemed".

34 C.F.R. § 682.410(a):

(a) Fiscal requirements. A guarantee agency shall establish, at a minimum, the following fiscal procedures:

(1) The guarantee agency shall establish and maintain a reserve fund to which the guarantee agency shall credit—

(i) Federal advances obtained under, and matching funds required by, section 422(a) of the Act;

(ii) Funds appropriated by a State for the agency's loan guarantee program;

(iii) Federal advances obtained under § 682.403;

(iv) Funds received by the guarantee agency as loan insurance premiums;

(v) Administrative cost allowances received by the guarantee agency under § 682.407;

(vi) Funds received by the guarantee agency for the agency's loan guarantee program from gift, grant, or other sources;

(vii) Funds collected on defaulted loans;

(viii) Death, disability, bankruptcy, and reinsurance payments received from the Secretary; and

(ix) Funds earned from investments under paragraph (a)(5) of this section.

(2) Except as provided in paragraphs (a)(3) and (a)(4) of this section, a guarantee agency may use the assets of the reserve fund established under paragraph (a)(1) of this section only to—

(i) Guarantee loans under the guarantee agency's loan guarantee program;

(ii) Pay default claims;

(iii) Pay death, disability, and bankruptcy claims;

(iv) Refund overpayments of insurance premiums;

(v) Pay to the Secretary the Secretary's equitable share of borrower payments; and

(vi) Repay advances made by the Secretary.

(3) Except as provided in paragraph (a)(4) of this section, a guarantee agency may also use loan insurance premiums, administrative cost allowances, interest or investment earnings, and funds described in paragraph (a)(1)(vi) of this section for payments necessary for the proper administration of the guarantee agency's loan guarantee program.

(4)(i) The guarantee agency may use the amount of Federal advances identified in paragraph (a)(1)(iii) of this section, and interest or other earnings on those advances, only to pay default claims.

(ii) The guarantee agency shall account separately for the funds described in paragraph (a)(4)(i) of this section.

(5) The guarantee agency may invest the assets of the reserve fund described in paragraph (a)(1) of this section only in low-risk securities, such as obligations issued or guaranteed by the United States or a State, and shall exercise the level of care in that investment required of a fiduciary charged with the duty of investing the money of others.

(6) If the guarantee agency uses loan insurance premiums or funds earned from investments under paragraph (a)(5) of this section to buy an asset and—

(i) If the agency subsequently sells that asset, the agency shall promptly deposit into the reserve fund described in paragraph (a)(1) of this section a percentage of the sale proceeds equal to the percentage of the original purchase price of the asset paid with the insurance premiums and investment earnings; or

(ii) If the agency subsequently converts the asset to a use unrelated to its GSLP or PLUS loan guarantee program, the agency shall promptly deposit into the reserve fund described in paragraph (a)(1) of this section a percentage of the fair market value of the asset equal to the percentage of the original purchase price paid with the insurance premiums or investment earnings.